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# Independence compliance : checklists and tools for complying with AICPA, SEC, and PCAOB independence requirements

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# Independence Compliance

*Checklists and Tools for Complying With AICPA, SEC, and  
PCAOB Independence Requirements*

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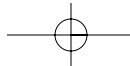
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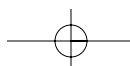


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## Notice to Readers

This publication, *Independence Compliance: Checklists and Tools for Complying With AICPA, SEC, and PCAOB Independence Requirements*, is a practice aid that helps practitioners comply with independence rules that apply if a practitioner is engaged in an audit or attestation engagement for a public company. This practice aid covers both AICPA independence requirements that apply to all audit and attestation engagements and Securities and Exchange Commission (SEC) and Public Company Accounting Oversight Board (PCAOB) independence requirements that apply to audit and attestation services provided to public companies and other entities whose financial information is filed with the SEC.

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The first edition of this publication was developed in October 2006. This is the second edition of this publication and the content herein reflects the AICPA, SEC, and PCAOB independence rules that were in effect in March 2009. AICPA, SEC, and PCAOB independence rules may have changed since this publication was developed. Practitioners should be aware of and comply with current AICPA, SEC, and PCAOB independence rules.

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Edited by Dennis W. Ridge, Jr., CPA  
*Technical Manager*  
*Accounting and Auditing Publications*

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## About the Author

Since 1992, Ms. Allen has been extensively involved in counseling; teaching; and developing rules, policies, training courses, and practice tools on ethics and independence. She formed the consulting firm AUDIT CONDUCT, LLC in 2005 to provide guidance on auditor independence, ethics, and related compliance matters for CPA firms, professional organizations, corporate governance bodies and their advisers, law firms, and other stakeholders of the accounting profession. Ms. Allen has many years of experience working with the accounting profession's ethics standards as a senior staff member of the AICPA's Professional Ethics Division and Director of Independence for two of the "big four" accounting firms. She also taught accounting principles at The City University of New York's Queens and Baruch Colleges.

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## Introduction

.01 U.S. auditor independence rules have undergone many significant changes in the last decade, and the rules continue to evolve. With rules covering many situations in which independence might be impaired, from business relationships and services to fee arrangements and other relationships, it has become increasingly difficult for practitioners to keep up with the standards. This practice aid will assist practitioners and firms in identifying and addressing independence matters to help ensure their compliance with applicable AICPA professional standards and Securities and Exchange Commission (SEC) independence rules, including rules of the Public Company Accounting Oversight Board (PCAOB) and the Independence Standards Board (ISB), when applicable. SEC, PCAOB, and ISB rules will collectively be referred to as SEC independence rules.

## References to Professional Standards

.02 In citing the professional standards, references are made to the AICPA *Professional Standards* publication. In those sections of the technical practice aid when specific PCAOB auditing standards are referred to, references are made to the AICPA's *PCAOB Standards and Related Rules* publication. Additionally, when referencing professional standards, this technical practice aid cites section numbers and not the original statement number, as appropriate. For example, Statement on Auditing Standards (SAS) No. 54, *Illegal Acts by Clients* (AICPA, *Professional Standards*, vol. 1, AU sec. 317), is referred to as AU section 317 (AICPA, *Professional Standards*, vol. 1).

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## Scope of This Practice Aid

.03 This practice aid addresses two diverse sets of auditor independence rules. First, the independence compliance tool (the compliance tool) addresses the requirements of Rule 101, *Independence* (AICPA, *Professional Standards*, vol. 2, ET sec. 101 par. .01), of the AICPA Code of Professional Conduct (code) and its related rulings and interpretations. This rule applies to all engagements requiring independence under AICPA *Professional Standards*. Some examples are the following:

- ▶ Audits and reviews of financial statements
- ▶ Compilations of financial statements in which the firm does not disclose a lack of independence
- ▶ SAS No. 70 reports issued under AU section 324, *Service Organizations* (AICPA, *Professional Standards*, vol. 1)
- ▶ Other attestation services, such as agreed-upon procedures

.04 The compliance tool also addresses the SEC independence rules, which apply to audits, reviews, and other attest services provided to public companies and other entities whose financial information is filed with the SEC. These engagements also are subject to the AICPA rules described in the compliance tool. To streamline the compliance process, the compliance tool will address SEC independence rules only to the extent that they exceed the AICPA requirements. Hence, completing the entire compliance tool serves to address both sets of rules.

.05 If an engagement is not subject to SEC independence rules, only the AICPA portion of the compliance tool should be completed.<sup>1</sup>

## How to Use This Practice Aid

.06 To assess independence

- ▶ determine which compliance tools apply to your attest client (that is, AICPA only or AICPA plus SEC).
- ▶ read all portions of the practice aid applicable to your client.

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1. Practitioners also should be aware of various other regulations that may apply to engagements. See appendix C, "Sources of Guidance," and appendix G, "Other Independence Rules and Issues," for further information.

- ▶ complete the relevant questionnaire(s) found in part I of the compliance tool(s).
- ▶ review the follow-up section(s) for all “Yes” answers or if an answer is not known.
- ▶ complete both the AICPA and SEC compliance tools for SEC engagements.
- ▶ review the appendixes for additional information that may be relevant for your client.

## The AICPA and SEC Independence Compliance Tools

.07 Each compliance tool is a mechanism to help you consider whether your firm is independent to perform an attest engagement under the relevant rules. The compliance tools are divided into two equally important parts.

.08 Part I of the compliance tool is a series of questions designed to help you identify potential independence issues. You should answer all of the AICPA questions listed in part I of the compliance tool. If your client is subject to SEC independence rules, you should answer the SEC questions in part I as well. (Questions and rule citations that relate exclusively to practitioners applying SEC independence rules are shown in italics.) The response to each question will be “Yes” or “No,” although certain questions allow for an “N/A” (not applicable) response. Refer to the glossaries in appendix A, “AICPA Independence Terms,” and appendix B, “SEC Independence Terms,” to ensure that you fully understand the terms used in the question before providing your answer.

.09 Terms defined in appendixes A and B are shown in italics; however, when an SEC term, as defined in appendix B, appears in questions and rule citations that relate exclusively to practitioners applying SEC independence rules, the defined term is shown in reverse italics. Reverse italics is used in this situation because questions and rule citations that relate exclusively to practitioners applying SEC independence rules are already shown in italics. Recall that for SEC engagements, you need to complete both the SEC and AICPA questions; therefore, you need to understand the terms appearing in both glossaries (appendixes A and B) and apply whichever term provides the most conservative interpretation. Then, ask the appropriate person(s) in your firm to determine the proper reply to the question.

.10 It is important to note that the questionnaire summarizes the most frequently encountered independence rules; accordingly, the questions do not identify all the possible factors that determine whether independence under the applicable rules is achieved. Further, some areas of the rules are very fact-specific and may not be fully addressed with a simple “Yes” or “No” answer. Therefore, you should not assume that all “Yes” answers

indicate an infraction of the rules, but rather that further consideration of the rules themselves and additional advice and counsel may be needed to determine if an issue exists.

.11 If you answer “Yes” to any of the questions or you are unable to answer a question, you also should review part II of the compliance tool. Part II will help you to address and, if necessary, document any potential independence issues that have been identified in part I. Part II suggests possible follow-up actions that you and your firm may wish to consider and apply in addressing an independence issue. (Like part I, information applying exclusively to practitioners applying SEC independence rules is shown in italics.) However, applying the suggested follow-up actions may or may not avoid a violation of the code or SEC independence rules. Only the AICPA Professional Ethics Executive Committee has the authority to interpret the code. Similarly, the SEC Office of the Chief Accountant (Professional Practice group) is responsible for addressing matters relevant to SEC independence rules.

.12 To be effective, you should use the compliance tool(s) in a timely manner. The following scenarios illustrate the meaning of timely.

### **Scenario 1: The engagement is a new audit, review, or other attest engagement.**

.13 You should utilize the compliance tool prior to accepting an attest engagement or performing any attest work for the client. In a number of cases, this will allow the firm to resolve issues that surface as a result of the review. Prior to issuing your report, you should review your previous results to confirm that no changes have occurred since your initial assessment and that any matters identified during the initial assessment have been appropriately addressed, resolved, and documented.

### **Scenario 2: The engagement is an ongoing audit, review, or other attest engagement.**

.14 You should use the compliance tool early in the audit planning stage and at other times throughout the year, as needed. Prior to issuing your report, you should review the previous results to confirm that no changes have occurred since your initial assessment and that any matters identified during the initial assessment have been appropriately addressed, resolved, and documented.



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# Independence Compliance Tool: AICPA and SEC Independence Rules

## AICPA Rules

.15 AICPA professional standards require a firm, its partners, and professional employees to be independent in accordance with Ethics Rule 101 of the code whenever a firm performs an attest service for a client. Attest services include the following:

- ▶ Financial statement audits
- ▶ Financial statement reviews
- ▶ Other attest services, as defined in the Statements on Standards for Attestation Engagements

.16 Performing a compilation of a client's financial statements does not require independence; however, if a firm that is not independent issues a compilation report, the report must state, "I am (we are) not independent with respect to XYZ Company." If the firm does not include this disclosure in the compilation report, it must maintain independence under Ethics Rule 101 of the code.

.17 The questionnaire shown in an upcoming section addresses the following five general categories under AICPA and SEC independence rules:

- ▶ Personal financial interests and relationships
- ▶ Employment and business relationships
- ▶ Nonattest services engagements
- ▶ Fee arrangements
- ▶ Miscellaneous

## SEC Independence Rules

.18 The SEC regulates public companies<sup>2</sup> and establishes the qualifications of independent auditors under item (b) of Rule 2-01, "Qualifications of Accountants," of Regulation

2. Companies that are registered with or are otherwise regulated by the Securities and Exchange Commission (SEC) or that file audited financial statements with the SEC, including foreign filers, are considered public companies, or issuers.

S-X. The rule does not purport to describe all of the circumstances that raise independence concerns. Accordingly, the SEC will not recognize an accountant as independent with respect to an attest client if the accountant is not capable of exercising objective and impartial judgment on all issues encompassed within the engagement. The practitioner also must consider whether a reasonable investor with knowledge of all relevant facts and circumstances would conclude that the accountant is independent.<sup>3</sup>

.19 The SEC oversees the PCAOB, a private standards-setting body that is authorized to, among other things, set auditing, quality control, and ethics and independence standards for accounting firms that audit public companies. The PCAOB adopted interim ethics standards based on the provisions of Rule 102, *Integrity and Objectivity* (AICPA, *Professional Standards*, vol. 2, ET sec. 102); Ethics Rule 101; and interpretations and rulings under those rules as of April 16, 2003. The PCAOB also adopted the ISB standards and interpretations. To the extent that the SEC independence rules are more restrictive than the PCAOB interim independence standards, registered public accounting firms must comply with the more restrictive requirements. The compliance tool is designed to help you consider the most restrictive SEC rules that apply to your engagement.

.20 A citation to the applicable AICPA Ethics Rule in volume 2 of *Professional Standards* or SEC independence rule or related guidance, or both, follows each question. If the AICPA and SEC rules on a particular matter are similar (for example, direct financial interests), they are addressed in the same question with citations to each rule provided (note that citations to the SEC rules will be shown in italics). If the AICPA and SEC rules differ (for example, loans), they are addressed in separate questions. You should refer directly to the rules if you do not understand the question or need further information (also see appendix C, "Sources of Guidance"). Terms defined in appendixes A and B are shown in italics; however, when an SEC term, as defined in appendix B, appears in questions and rule citations that relate exclusively to practitioners applying SEC independence rules, the defined term is shown in reverse italics. Reverse italics is used in this situation because questions and rule citations that relate exclusively to practitioners applying SEC independence rules are already shown in italics. It is very important that you understand the meaning of all terms used in the questions before you provide a response.

.21 The independence rules are frequently augmented and amended. Consequently, the independence rules addressed and citations referred to in the questionnaire may have changed after the development of this practice aid. You should be aware of and comply with current independence rules.

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3. The SEC will not recognize any person as a CPA who is not duly registered and in good standing under the laws of the place of his or her residence or principal office. Also, under various state rules, the person or accounting firm, or both, must be licensed to perform the work if the service is being performed in a state other than the state in which the person or firm is registered.

## Part I: Questionnaire

### Category 1: Personal Financial Interests and Relationships

.22 The following are important points:

- ▶ The time period you should consider for purposes of these questions is the *period of the professional engagement*. This period begins on the earlier of the date the *firm* (a) formally agrees to perform attest services for the *client* or (b) begins providing attest services. It continues until the *firm* or the *client* terminates the attest relationship or the final report is issued, whichever is later.
- ▶ The terms *covered member* or *covered person* are specific to the *client* or *audit client* being assessed.
- ▶ For purposes of these questions, *covered member* or *covered person* includes the *covered member's* (or *covered person's*) *immediate family*, namely, his or her spouse, *spousal equivalent*, and *dependents*.
- ▶ For SEC engagements, the term *covered member* includes all of the persons included in the term *covered person* (the term used in the SEC independence rules). However, the term *covered member* incorporates the accounting firm as a whole, whereas the term *covered person* does not. Therefore, when appropriate, the questionnaire will address the rules for covered persons separately from those rules only applying to accounting firms.
- ▶ The term *audit client*, as used in the SEC independence rules, includes an affiliate of the audit client (see appendix B).<sup>4</sup>

Q1. Has a *covered member*<sup>5</sup> had or been committed to acquire any *direct financial interest* in the *client*?

[ET sec. 101 par. .02 and .17; SEC Regulation S-X Rule 2-01(c)(1)(i)(A)]

Yes ☐ No ☐

Q2. Has a *covered member* had a *direct financial interest* or a material *indirect financial interest* in the *client* through his or her participation in a retirement, savings, compensation, or similar plan? [ET sec. 101 par. .02 and .17; SEC Regulation S-X Rule

2-01(c)(1)(i)(A)]

Yes ☐ No ☐

4. The SEC defines affiliate of the audit client broadly; those unfamiliar with the term should review it carefully before proceeding with the questionnaire.

5. According to the AICPA, the term *covered member* includes the firm.

Q3. Has a *covered member* had an insurance policy that had an investment option that provided the *covered member* a *direct financial interest* or a material *indirect financial interest* in the *client*? [ET sec. 101 par. .17; SEC Regulation S-X Rule 2-01(c)(1)(i)(A)]

Yes ☐ No ☐

Q4. Has a *covered member* had or been committed to acquire any material *indirect financial interest* in the *client*, other than an *indirect financial interest* held through a *diversified mutual fund*? [ET sec. 101 par. .17; SEC Regulation S-X Rule 2-01(c)(1)(i)(D)]

Yes ☐ No ☐

Q5. Has a *covered member* acquired a *direct financial interest* or material *indirect financial interest* in the *client* as a result of an unsolicited gift or inheritance? [ET sec. 101 par. .17; SEC Regulation S-X Rule 2-01(c)(1)(iii)(A)]

Yes ☐ No ☐

Q6. If the *client* is a Section 529 savings plan, has a *covered member* been an account owner in the plan? [ET sec. 101 par. .17]

Yes ☐ No ☐ N/A ☐

Q7. Has a *covered member* been the account owner of any Section 529 savings plan (including nonclient plans) that invested in the *client*? [ET sec. 101 par. .17]

Yes ☐ No ☐

Q8. Has a *covered member* invested as a general partner in a partnership (or held another position that allowed the individual to control the partnership or participate in its investment decision making) that invested in the *client*? [ET sec. 101 par. .17; SEC Regulation S-X Rule 2-01(c)(1)(i)(A)]

Yes ☐ No ☐

Q9. Has a *covered member* invested as a limited partner in a partnership that invested in the *client* and was material to the *covered member*? [ET sec. 191 par. .162-.163; SEC Regulation S-X Rule 2-01(c)(1)(i)(A)]

Yes ☐ No ☐

Q10. Has a *covered member* served as the manager of a limited liability company (LLC) or held another position that allowed the individual to control the LLC or participate in its investment decision making, and that LLC invested in the *client*? [ET sec. 101 par. .17; SEC Regulation S-X Rule 2-01(c)(1)(i)(A)]

Yes ☐ No ☐



Q11. Was a member of the *attest engagement team* aware that a *close relative* had or was committed to acquire a material *financial interest* in the *client*?

[ET sec. 101 par. .02]

Yes ☐ No ☐

Q12. Did a *close relative* of a member of the *attest engagement team* have the ability to exercise *significant influence* over the *client*? [ET sec. 101 par. .02]

Yes ☐ No ☐

Q13. Did a *close relative* of (a) a *partner* or *manager* providing nonattest services to the *client* or (b) a *partner* in the *office* of the lead audit *partner* for this engagement have a *financial interest* that was both material to the *close relative* and allowed the *close relative* to exercise *significant influence* over the *client*?

[ET sec. 101 par. .02]

Yes ☐ No ☐

Q14. Has a *covered member* served as a trustee of a trust or executor or administrator of an estate if such trust or estate had or was committed to acquire a *direct financial interest* or material *indirect financial interest* in the *client*, such that (a) the *covered member* (individually or with others) had the authority to make investment decisions for the trust or estate, (b) the trust or estate owned or was committed to acquire more than 10 percent of the *client's* outstanding equity securities or other ownership interests, or (c) the value of the trust's or estate's holdings in the *client* exceeded 10 percent of the total assets of the trust or estate? [ET sec. 101 par. .02; SEC Regulation S-X Rule 2-01(c)(1)(i)(C)]

Yes ☐ No ☐

Q15. Has a *covered member* been the grantor of a trust that had or was committed to acquire a *direct financial interest* or material *indirect financial interest* in the *client*? [ET sec. 101 par. .17; SEC Regulation S-X Rule 2-01(c)(1)(i)(A)]

Yes ☐ No ☐

Q16. If the *covered member* has been the grantor of a trust, did the *covered member* retain the right to amend or revoke the trust or otherwise have the authority to control the trust or supervise or participate in the trust's investment decisions? [ET sec. 101 par. .17; SEC Regulation S-X Rule 2-01(c)(1)(i)(c)]

Yes ☐ No ☐ N/A ☐

Q17. Has a *covered member* been a beneficiary of a trust that had or was committed to acquire a material *financial interest* in the *client*? [ET sec. 101 par. .17; *SEC Regulation S-X Rule 2-01(c)(1)(i)(A)*]

Yes ☐ No ☐

Q18. Has a *covered member* been the beneficiary of a trust that had or was committed to acquire a *financial interest* in the *client* and the *covered member* was able to control or participate in investment decision making for the trust? [ET sec. 101 par. .17; *SEC Regulation S-X Rule 2-01(c)(1)(i)(A)*]

Yes ☐ No ☐

Q19. Has a *covered member* been a beneficiary of a blind trust that had or was committed to acquire a *financial interest* in the *client*? [ET sec. 101 par. .17]

Yes ☐ No ☐

Q20. Has a *covered member* had a *joint closely held investment* that was material to the *covered member's* net worth? [ET sec. 101 par. .02]

Yes ☐ No ☐

Q20a. Has a covered person had any *joint closely held investment* with the audit client? [*SEC Regulation S-X Rule 2-01(c)(3)*]

Yes ☐ No ☐

Q21. Has a *covered member* had a *loan* (other than a *grandfathered loan* or a *permitted loan*) to or from the *client*, any officer or director of the *client*, or any individual owning 10 percent or more of the *client's* outstanding equity? [ET sec. 101 par. .07]

Yes ☐ No ☐

Q21a. Has a covered person or the accounting firm had a *loan* to or from the audit client or the audit client's officers, directors, or owners of more than 10 percent of the audit client's equity securities (excluding the following loans that the covered person obtained from a financial institution under normal lending procedures, terms, and requirements: [1] a *permitted loan* or [2] a *grandfathered mortgage loan collateralized by the borrower's primary residence*)? [*SEC Regulation S-X Rules 2-01(c)(1)(ii)(A) and 2-01(c)(1)(ii)(E)*; question 1 under the heading "Financial Relationships" in Office of the Chief Accountant: Application of the Commission's Rules on Auditor Independence—

Frequently Asked Questions (*issued August 6, 2007*)]  
Also see appendix C for the URL to this SEC frequently  
asked question (FAQ).

Yes ☐ No ☐

Q22. Has a *covered member* had a *loan* with a  
nonclient subsidiary or parent of the *client* that was  
neither a *grandfathered loan* nor a *permitted loan*?  
[ET sec. 191 par. .196–.197]

Yes ☐ No ☐

Q23. Has a *partner* or professional employee of the  
*firm*, his or her *immediate family*, or a group of such  
persons acting together owned more than 5 percent  
of the *client's* outstanding equity securities or similar  
ownership interests? [ET sec. 101 par. .02]

Yes ☐ No ☐

Q23a. Did the *immediate family of any partner*  
or *professional employee of the accounting firm* file  
a Schedule 13D or 13G (Title 17 U.S. Code of  
Federal Regulations [CFR] Part 240.13d–101 or  
Part 240.13d–102) with the SEC indicating beneficial  
ownership of more than 5 percent of the audit client's  
equity securities, or did such person control the audit  
client? [SEC Regulation S-X Rule 2-01(c)(1)(i)(B)]

Yes ☐ No ☐

Q23b. Did the close relative of a covered person in  
the accounting firm file a Schedule 13D or 13G  
(17 U.S. CFR 240.13d–101 or 240.13d–102) with  
the SEC indicating beneficial ownership of more than  
5 percent of the audit client's equity securities, or did  
such relative control the audit client? [SEC Regulation  
S-X Rule 2-01(c)(1)(i)(B)]

Yes ☐ No ☐

Q23c. Did any group of the persons indicated in the  
preceding questions 23a and 23b file a Schedule 13D  
or 13G (17 U.S. CFR 240.13d–101 or 240.13d–102)  
with the SEC indicating beneficial ownership of more  
than 5 percent of the audit client's equity securities, or  
did such group of persons control the audit client?  
[SEC Regulation S-X Rule 2-01(c)(1)(i)(B)]

Yes ☐ No ☐

Q23d. Did the close relative of a partner in the  
accounting firm control the audit client?  
[SEC Regulation S-X Rule 2-01(c)(1)(i)(B)]

Yes ☐ No ☐

Q24. Did the *firm* hire professional staff or admit a *partner* who was a *covered member* with respect to the *client* and who had (1) a *loan* with the *client* that was neither a *grandfathered loan* nor a *permitted loan* or (2) a *direct financial interest* or material *indirect financial interest* in the *client*? [ET sec. 101 par. .02 and .07; SEC Regulation S-X Rules 2-01(c)(1)(i)(A), 2-01(c)(1)(i)(B), 2-01(c)(1)(i)(D), 2-01(c)(1)(ii)(A), and 201(c)(1)(ii)(E)]

Yes ☐ No ☐

Q25. If the *client* is a *financial institution*, has a *covered member* had a depository account (checking, savings, money market, or certificate of deposit) with a *client* holding funds that were not fully insured by a federal or state agency (such as the Federal Deposit Insurance Corporation [FDIC]) or other insurer and were material to the *covered member's* net worth? [ET sec. 191 par. .140–.141]

Yes ☐ No ☐ N/A ☐

Q25a. If the audit client is a *financial institution*, has a *covered person* had a *savings, checking, or similar account* with the audit client holding funds that were not fully insured by the FDIC (or another insurer)? [SEC Regulation S-X Rule 2-01(c)(1)(ii)(B)]

Yes ☐ No ☐ N/A ☐

Q25b. If the audit client is a *financial institution*, has the accounting firm had a *savings, checking, or similar account* with a *financial institution* audit client that held funds that were not fully insured by the FDIC (or another insurer), and the likelihood of the audit client experiencing financial difficulties was more than remote? [SEC Regulation S-X Rule 2-01(c)(1)(ii)(B)]

Yes ☐ No ☐ N/A ☐

Q25c. If the audit client is an *insurance company*, has a person in the accounting firm, while a *covered person*, obtained an *insurance policy* with the audit client? [SEC Regulation S-X Rule 2-01(c)(1)(ii)(F)]

Yes ☐ No ☐ N/A ☐

Q25d. If the audit client is an *insurance company*, has a person in the accounting firm, while a *covered person*, amended an existing *insurance policy* that required new underwriting by the audit client? [SEC Regulation S-X Rule 2-01(c)(1)(ii)(F)]

Yes ☐ No ☐ N/A ☐



Q26. If the *audit client* is a broker-dealer, has a *covered member* had a margin loan with the *audit client*?

[ET sec. 101 par. .07; SEC Regulation S-X Rule 2-01(c)(1)(ii)(A)]

Yes ☐ No ☐ N/A ☐

Q26a. If the *audit client* is a broker-dealer, has a *covered member* had a brokerage account that included any asset other than cash or securities or was not insured (that is, exceeded the amount provided for under the Securities Investor Protection Act of 1970)? [SEC Regulation S-X Rule 2-01(c)(1)(ii)(C)]

Yes ☐ No ☐ N/A ☐

Q27. Has a *covered member* invested in an entity that had *significant influence* over the *client* and that was material to the *client*? [ET sec. 101 par. .10; SEC Regulation S-X Rule 2-01(c)(1)(i)(E)]

Yes ☐ No ☐

Q28. Has a *covered member* invested in an entity over which the *client* had *significant influence* and the entity was material to the *client*? [ET sec. 101 par. .10; SEC Regulation S-X Rule 2-01(c)(1)(i)(E)]

Yes ☐ No ☐

Q29. Has a *covered member* had an investment or other relationship with an entity that gave the *covered member* *significant influence* over the entity and such entity had *significant influence* over the *client*? [ET sec. 101 par. .10; SEC Regulation S-X Rule 2-01(c)(1)(i)(E)]

Yes ☐ No ☐

Q30. Has a member of the *attest engagement team* accepted a gift from the *client* that would be considered to be more than clearly insignificant? [ET sec. 191 par. .228–.229]

Yes ☐ No ☐

## Category 2: Employment and Business Relationships

.23 The following are important points:

- ▶ Unless noted otherwise, the time period you should consider for purposes of these questions is the *period of the professional engagement* and the period covered by the financial statements (or other subject matter of the *attest engagement*).
- ▶ Unless noted otherwise, the term *audit client*, as used in the SEC independence rules, includes an affiliate of the audit client (see appendix B).

Q1. Has a *partner* or professional employee served as a director, officer, or in any other managerial position (for example, general counsel or promoter) for the *client*? [ET sec. 101 par. .02; SEC Regulation S-X Rule 2-01(c)(2)(i)]

Yes ☐ No ☐

Q2. Has a *partner* or professional employee served the *client* or the *client's* pension or profit sharing trust as a promoter, underwriter, or voting trustee? [ET sec. 101 par. .02; SEC Regulation S-X Rule 2-01(c)(2)(i)]

Yes ☐ No ☐

Q3. Has the *close relative* of a *covered member* (excluding *covered members* who provided only nonattest services to the *client*) or the *immediate family* of such *covered member* been employed by the *client* in a *key position*? [ET sec. 101 par. .02 and ET sec. 92 par. .17]

Yes ☐ No ☐

Q3a. Has the *close relative* of a *covered member* or the *immediate family* of such *covered member* been employed by the audit client in an accounting role or a financial reporting oversight role? [SEC Regulation S-X Rule 2-01(c)(2)(ii)]

Yes ☐ No ☐

Q4. Did the *firm* hire professional staff or admit a *partner* who was associated with a *client* and who served on that *client's attest engagement team* or was an *individual in a position to influence the attest engagement* covering any period in which he or she was employed by or associated with the *client*? [ET sec. 101 par. .02; SEC Regulation S-X Rule 2-01(c)(2)(iv)]

Yes ☐ No ☐

Q5. Did a *partner* or professional employee who resigned or retired from the *firm* and assumed a *key position* with the *client* have (a) an arrangement to be paid amounts due him or her (for a previous interest in the *firm* or retirement benefits) calculated on a variable formula, (b) amounts due him or her (per item a) that were material to the *firm*, or (c) continuing business relationships with the *firm* (for example, consulting arrangements or other associations)? [ET sec. 101 par. .04; SEC Regulation S-X Rule 2-01(c)(2)(iii)]

Yes ☐ No ☐

*Q5a. Did a former partner or professional employee of the accounting firm assume a financial reporting oversight role or accounting role with the audit client and have a capital balance with the accounting firm or any financial arrangement with the firm that was dependent on the firm's revenues, profits, or earnings?*<sup>6</sup>  
[SEC Regulation S-X Rule 2-01(c)(2)(iv)]

Yes ☐ No ☐

*Q5b. If the audit client is an issuer or a subsidiary of an issuer, has a former member of the audit engagement team<sup>7</sup> assumed a financial reporting oversight role with the issuer during the past year?* [SEC Regulation S-X Rule 2-01(c)(2)(iii)(B) and (C); question 1 (issued August 13, 2003) and question 2 (issued August 13, 2003; revised 2007) under the heading "Cooling Off Period" in Office of the Chief Accountant: Application of the Commission's Rules on Auditor Independence—Frequently Asked Questions]

Yes ☐ No ☐ N/A ☐

*Q6. Did the firm and the client participate in a cooperative arrangement (for example, joint venture, subcontracting arrangement, distribution, or marketing arrangement) that was material to the firm or the client?*  
[ET sec. 101 par. .14]

Yes ☐ No ☐

*Q6a. Other than an ordinary consumer relationship in which transactions were made on an arm's length basis, did the accounting firm or any covered member in the accounting firm have a direct or material indirect business relationship with the audit client or its officers, directors, or substantial shareholders (for example, joint venture, limited partnership, investment in supplier or customer companies, certain leasing interests, or sale by the accounting firm of items other than professional services)?*  
[SEC Regulation S-X Rule 2-01(c)(3); question 2 under

6. Excludes a former professional employee who (1) was not a partner, principal, or shareholder of the accounting firm; (2) disassociated from the accounting firm more than five years ago; and (3) had a fixed financial arrangement with the accounting firm that was immaterial to the former professional employee and was not dependent upon the firm's earnings, revenues, or profits.

7. Excludes individuals (other than the lead or concurring review partner) who spent a de minimis amount of time on the engagement team.

*the heading “Other Matters” in Office of the Chief Accountant: Application of the Commission’s Rules on Auditor Independence—Frequently Asked Questions (issued January 16, 2001; revised 2004)]*

Yes ☐ No ☐

Q7. Did a member of the *attest engagement team* or an *individual in a position to influence the attest engagement* negotiate a potential employment position with the *client*? [ET sec. 101 par. .04; par. 2a of ISB Standard No. 3, *Employment with Audit Clients* (AICPA, *PCAOB Standards and Related Rules*, PCAOB Standards, As Amended, “Independence Standards Board”)]

Yes ☐ No ☐

### Category 3: Nonattest Services Engagements

.24 The following are important points:

- ▶ Before answering the questions in this category, you should determine whether your *firm* provided any nonattest services (including tax services) to the *client* (for *SEC purposes, this includes an affiliate of the audit client*) during the period described in the second bullet point that follows. If only attest services have been and are being performed for the *client* during these periods, you may skip this section.
- ▶ The time period you should consider for purposes of these questions is the *period of the professional engagement* and the period covered by the financial statements (or other subject matter of the *attest engagement*).
- ▶ For purposes of questions in this category, the terms *firm* and *accounting firm* include all professionals performing services on behalf of the *firm*.
- ▶ If this *client* is a new attest *client*, see the AICPA FAQs<sup>8</sup> under the heading “Period of the Professional Engagement” included in appendix F, “AICPA Professional Ethics Division Frequently Asked Questions—Performance of Nonattest Services,” of this practice aid. See appendix C for the URL to the AICPA FAQs.

8. The answers to these frequently asked questions (FAQs) are based on guidance the AICPA Professional Ethics Division staff provided in response to members’ inquiries concerning Interpretation No. 101-3, “Performance of Nonattest Services,” under Rule 101, *Independence* (AICPA, *Professional Standards*, vol. 2, ET sec. 101 par. .05). The FAQs are not rules, regulations, or statements of the Professional Ethics Executive Committee and, therefore, are not authoritative guidance.

- *The term audit client, as used in the SEC independence rules, includes an affiliate of the audit client (see appendix B and questions 8–9 under the heading “Prohibited and Non-audit Services” in Office of the Chief Accountant: Application of the Commission’s Rules on Auditor Independence—Frequently Asked Questions [issued August 6, 2007]).*

Q1. Did the *firm* perform any management functions or make managerial decisions for the *client* in connection with nonattest services? [ET sec. 101 par. .05; *SEC Regulation S-X Rule 2-01(c)(4)(vi)*] Also see the FAQ included in appendix F of this practice aid under the heading, “Management Functions.”

Yes ☐ No ☐

Q2. Were there any instances in which the *client* was unable (that is, lacked suitable skill, knowledge, and/or experience) or unwilling to perform management functions, set the scope of the *firm’s* nonattest services, and evaluate and accept responsibility for the results of the nonattest services? [ET sec. 101 par. .05] Also see the FAQs included in appendix F of this practice aid under the heading “Suitable Skill, Knowledge and/or Experience.”

Yes ☐ No ☐

Q3. Were there any instances in which an understanding between the *firm* and the *client* (that is, engagement objectives, nonattest services to be performed, *client’s* acceptance of its responsibilities, *firm’s* responsibilities, and engagement limitations, if any) was not reached and documented in the *firm’s* files? [ET sec. 101 par. .05] Also see the FAQs included in appendix F of this practice aid under the heading “Documentation Requirement.”

Yes ☐ No ☐

Q4. Did the *firm* at any time have custody of the *client’s* assets (for example, handle *client* cash, checks, or other financial instruments or otherwise take responsibility for the safekeeping of assets)? [ET sec. 101 par. .05; *SEC Regulation S-X Rules 2-01(c)(4)(vi)* and *2-01(c)(4)(viii)*]

Yes ☐ No ☐

Q5. Did the *firm* at any time assume responsibility for making payments on behalf of the *client* (electronically or otherwise)? [ET sec. 101 par. .05; *SEC Regulation S-X Rule 2-01(c)(4)(vi)*]

Yes ☐ No ☐

Q6. Did the *firm* at any time assume responsibility for signing or cosigning *client* checks? [ET sec. 101 par. .05; SEC Regulation S-X Rule 2-01(c)(4)(vi)]

Yes ☐ No ☐

Q7. Did the *firm* at any time maintain a bank account on behalf of the *client*? [ET sec. 101 par. .05; SEC Regulation S-X Rule 2-01(c)(4)(vi)]

Yes ☐ No ☐

Q8. Did the *firm* at any time sign payroll tax returns on behalf of the *client*? [ET sec. 101 par. .05; SEC Regulation S-X Rule 2-01(c)(4)(vi)]

Yes ☐ No ☐

Q9. Did the *firm* at any time authorize, execute, or consummate transactions on behalf of the *client* (for example, approve vendor invoices for payment, authorize payment of *client* funds, hire or terminate employees, or commit the *client* to employee compensation or benefit arrangements)? [ET sec. 101 par. .05; SEC Regulation S-X Rules 2-01(c)(4)(vi) and 2-01(c)(4)(vii)]

Yes ☐ No ☐

Q10. Did the *firm* at any time prepare *source documents* that evidenced accounting transactions (for example, invoices, purchase orders, or payroll timecards) for the *client*? [ET sec. 101 par. .05; SEC Regulation S-X Rule 2-01(c)(4)(i)(C)]

Yes ☐ No ☐

Q11. Did the *firm* at any time supervise the *client's* employees in their daily activities? [ET sec. 101 par. .05; SEC Regulation S-X Rule 2-01(c)(4)(vi)]

Yes ☐ No ☐

Q12. Did the *firm* at any time lend its professional staff to the *client*? [ET sec. 101 par. .02 and .05; SEC Regulation S-X Rule 2-01(c)(4)(vi)]

Yes ☐ No ☐

Q13. Did the *firm* at any time report to the board of directors (or other governing body) on behalf of management? [ET sec. 101 par. .05; SEC Regulation S-X Rule 2-01(c)(4)(vi)]

Yes ☐ No ☐

Q14. Did the *firm* at any time design or implement policies or procedures for the *client*? [ET sec. 101 par. .05; SEC Regulation S-X Rule 2-01(c)(4)(vi)]

Yes ☐ No ☐

Q15. Did the *firm* at any time serve as the *client's* escrow agent, stock transfer agent, registrar, general counsel, or in a similar capacity? [ET sec. 101 par. .05; *SEC Regulation S-X Rules 2-01(c)(4)(vi) and 2-01(c)(4)(ix)*]

Yes ☐ No ☐

Q16. Did the *firm* at any time serve an employee benefit plan *client* as a fiduciary as defined by the Employee Retirement Income Security Act of 1974? [ET sec. 101 par. .05 and ET sec. 102 par. .03; *SEC Regulation S-X Rule 2-01(c)(4)(vi)*]

Yes ☐ No ☐

Q17. Did the *firm* at any time make investment decisions for the *client* or have discretionary authority over *client* investments? [ET sec. 101 par. .05; *SEC Regulation S-X Rules 2-01(c)(4)(vi) and 2-01(c)(4)(viii)*]

Yes ☐ No ☐

Q18. Did the *firm* at any time execute transactions to buy or sell investments on behalf of the *client*? [ET sec. 101 par. .05; *SEC Regulation SX Rule 2-01(c)(4)(viii)*]

Yes ☐ No ☐

Q19. Did the *firm* at any time negotiate transactions on behalf of the *client*? [ET sec. 101 par. .05; *SEC Regulation S-X Rule 2-01(c)(4)(vi)*]

Yes ☐ No ☐

Q20. Did the *firm* at any time commit the *client* to the terms of an arrangement without the *client's* involvement or advanced agreement to the terms? [ET sec. 101 par. .05; *SEC Regulation S-X Rule 2-01(c)(4)(vi)*]

Yes ☐ No ☐

Q21. Did the *firm* perform any ongoing compliance or quality control functions for the *client*? [ET sec. 101 par. .05; *SEC Regulation S-X Rule 2-01(c)(4)(vi)*]

Yes ☐ No ☐

Q22. Did the *firm* perform bookkeeping services for the *client*? [ET sec. 101 par. .05; *SEC Regulation S-X Rule 2-01(c)(4)(i)*] (If the answer is "No," skip questions 23–25a.)

Yes ☐ No ☐

Q23. Did the *firm* determine or change journal entries without obtaining *client* approval? [ET sec. 101 par. .05] Also see the FAQs included in appendix F of this practice aid under the heading "Bookkeeping Services."

Yes ☐ No ☐



Q23a. Did the firm determine or change journal entries?  
[SEC Regulation S-X Rule 2-01(c)(4)(vi)]

Yes ☐ No ☐

Q24. Did the firm change source documents or account codings on transactions without client approval? [ET sec. 101 par. .05] Also see the FAQs included in appendix F of this practice aid under the heading “Bookkeeping Services.”

Yes ☐ No ☐

Q24a. Did the firm change source documents or account codings on transactions? [SEC Regulation S-X Rule 2-01(c)(4)(vi)]

Yes ☐ No ☐

Q25. Did the firm determine the assumptions underlying journal entries (for example, useful lives or bad debt percentages) for the client? [ET sec. 101 par. .05; SEC Regulation S-X Rules 2-01(c)(4)(i) and 2-01(c)(4)(vi)] Also see the FAQs included in appendix F of this practice aid under the heading “Bookkeeping Services.”

Yes ☐ No ☐

Q25a. Did the accounting firm (a) maintain or prepare the audit client’s accounting records (for example, payroll) or prepare or originate source data underlying the financial statements (for example, contracts, shipping forms, or invoices) that form the basis of financial statements or (b) in any other manner prepare the client’s financial statements that are filed with the SEC? [SEC Regulation S-X Rule 2-01(c)(4)(vi)]

Yes ☐ No ☐

Q26. Did the firm design or develop a financial information system for the client (including selling or licensing software that the firm designed or developed)? [ET sec. 101 par. .05; SEC Regulation S-X Rule 2-01(c)(4)(ii)]

Yes ☐ No ☐

Q26a. Did the accounting firm license or sell software (such as tax preparation software) to the audit client, which aggregated source data or generated information that was used in preparing the audit client’s financial statements or that helped form the basis of such statements? [SEC Regulation S-X Rule 2-01(c)(4)(ii); question 6 under the heading “Prohibited and Non-audit



*Services*” in Office of the Chief Accountant: Application of the Commission’s Rules on Auditor Independence—Frequently Asked Questions (*issued August 13, 2003*)]

Yes ☐ No ☐

Q26b. Did the accounting firm design or implement a hardware or software system that aggregated source data underlying the financial statements or generated information that was significant to the audit client’s financial statements? [SEC Regulation S-X Rule 2-01(c)(4)(ii)]

Yes ☐ No ☐

Q27. Did the firm modify the source code underlying the client’s financial information system (excluding insignificant modifications)? [ET sec. 101 par. .05; SEC Regulation S-X Rule 2-01(c)(4)(ii)] Also see the FAQs included in appendix F of this practice aid under the heading “Information Technology Services.”

Yes ☐ No ☐

Q28. Did the firm manage or operate the audit client’s local area network? [ET sec. 101 par. .05; SEC Regulation S-X Rule 2-01(c)(4)(ii)] Also see the FAQs included in appendix F of this practice aid under the heading “Information Technology Services.”

Yes ☐ No ☐

Q29. Did the firm provide valuation or appraisal services to the client that were subject to significant subjectivity and whose results were material to the financial statements? [ET sec. 101 par. .05; SEC Regulation S-X Rule 2-01(c)(4)(iii)] Also see the FAQ included in appendix F of this practice aid under the heading “Appraisal, Valuation, and Actuarial Services.”

Yes ☐ No ☐

Q29a. Did the accounting firm perform any appraisal service, valuation service, or any service involving a fairness opinion or contribution-in-kind report for the audit client? [SEC Regulation S-X Rule 2-01(c)(4)(iii)]

Yes ☐ No ☐

Q30. Did the firm perform an actuarial valuation for the client (except for those related to the client’s pension or postemployment benefit obligations) that was material to the financial statements? [ET sec. 101 par. .05] Also see the FAQ included in appendix F of this practice aid under the heading “Appraisal, Valuation, and Actuarial Services.”

Yes ☐ No ☐

Q30a. Did the accounting firm perform any actuarial advisory service involving the determination of amounts recorded in the financial statements and related accounts for the audit client?<sup>9</sup> [SEC Regulation S-X Rule 2-01(c)(4)(iv)]

Yes ☐ No ☐

Q31. Did the firm provide internal audit services to the client? [ET sec. 101 par. .05; SEC Regulation S-X Rule 2-01(c)(4)(v)] (If the answer is “No,” skip questions 32–36.)

Yes ☐ No ☐

Q32. Did the firm manage internal audit activities for the client? [ET sec. 101 par. .05; SEC Regulation S-X Rule 2-01(c)(4)(v)]

Yes ☐ No ☐

Q33. Did the firm determine the scope, risk, or frequency of internal audit activities for the client, including those performed by the firm (for example, preparing or approving the audit work plan)? [ET sec. 101.05; SEC Regulation S-X Rule 2-01(c)(4)(v)]

Yes ☐ No ☐

Q34. In performing internal audit services, did the firm evaluate the findings of internal audit activities, including those performed by the firm? [ET sec. 101 par. .05; SEC Regulation S-X Rule 2-01(c)(4)(v)]

Yes ☐ No ☐

Q35. In performing internal audit services, did the firm determine the adequacy of internal audit activities, including those performed by the firm? [ET sec. 101 par. .05; SEC Regulation S-X Rule 2-01(c)(4)(v)]

Yes ☐ No ☐

Q36. Did the firm report internal audit findings to the board of directors or other governing body on behalf of the client? [ET sec. 101 par. .05; SEC Regulation S-X Rule 2-01(c)(4)(v)]

Yes ☐ No ☐

Q37. Did the accounting firm search for prospective candidates for managerial, executive, or director positions for the audit client? [SEC Regulation S-X Rule 2-01(c)(4)(vii)(A)]

Yes ☐ No ☐

<sup>9</sup> Excludes services in which the accounting firm solely helped the client understand the methods, models, assumptions, and inputs used in computing the amounts that were determined by the client or another party (unrelated to the accounting firm).

Q38. Did the accounting firm conduct formal testing (for example, psychological testing) or evaluation programs of prospective employment candidates for the audit client? [SEC Regulation S-X Rule 2-01(c)(4)(vii)(B)]

Yes ☐ No ☐

Q39. Did the accounting firm perform reference checks of prospective employment candidates for the audit client? [SEC Regulation S-X Rule 2-01(c)(4)(vii)(C)]

Yes ☐ No ☐

Q40. Did the accounting firm recommend that the audit client hire a specific candidate for a specific job?<sup>10</sup> [SEC Regulation S-X Rule 2-01(c)(4)(vii)(E)]

Yes ☐ No ☐

Q41. Did the accounting firm act as broker-dealer (registered or unregistered) for the audit client? [SEC Regulation S-X Rule 2-01(c)(4)(viii)]

Yes ☐ No ☐

Q42. Did the accounting firm provide any legal services to the audit client that, in the jurisdiction in which the service was provided, required a service provider to be licensed, admitted, or otherwise qualified to practice law? [SEC Regulation S-X Rule 2-01(c)(4)(ix)]

Yes ☐ No ☐

Q43. Did the accounting firm provide an expert opinion or other expert service for the audit client or the audit client's legal counsel for the purpose of advocating the client's interests in litigation or in a regulatory or administrative proceeding or investigation?<sup>11</sup> [SEC Regulation S-X Rule 2-01(c)(4)(x)]

Yes ☐ No ☐

Q44. Except for a power of attorney limited to tax-related activities, did the firm obtain a power of attorney to act on behalf of the client? [ET sec. 101 par. .05]

Yes ☐ No ☐

Q45. Did the firm represent the client in court (for example, tax, district, or federal court of claims and the equivalent state, local, or foreign forum)? [ET sec. 101 par. .05]

Yes ☐ No ☐

10. When requested by the audit client, excludes interviewing candidates and advising the client on the competency of individuals for accounting, administrative, or control positions.

11. Excludes situations in which the accounting firm provides factual accounts (including in testimony) to explain positions it took in connection with previously rendered services.

Q46. Did the *firm* provide or agree to provide (either conditionally or unconditionally) expert witness services to the *client*? [ET sec. 101 par. .05]

Yes ☐ No ☐

Q47. Did the accounting firm provide personal tax services to an individual who was in a financial reporting oversight role at the audit client or his or her immediate family member (unless this is a new audit client and the services were only performed during the audit period preceding the beginning of the professional engagement period)?<sup>12</sup> [PCAOB Rule 3523, Tax Services for Persons in Financial Reporting Oversight Roles (AICPA, PCAOB Standards and Related Rules, *Rules of the Board*, "Rules")] Also see questions 5–6 of PCAOB staff questions and answers Ethics and Independence Rules Concerning Independence, Tax Services, and Contingent Fees (issued April 3, 2007). (See appendix C for the URL to this PCAOB staff questions and answers document.)

Yes ☐ No ☐

Q48. Did the accounting firm provide services to the audit client that involved marketing, planning, or opining in favor of a confidential transaction or an aggressive tax position (including listed transactions)? [PCAOB Rule 3522, Tax Transactions (AICPA, PCAOB Standards and Related Rules, *Rules of the Board*, "Rules")] Also see questions 1–4 of PCAOB staff questions and answers Ethics and Independence Rules Concerning Independence, Tax Services, and Contingent Fees (issued April 3, 2007).

Yes ☐ No ☐

Q49. Has the accounting firm been engaged to perform (or has the firm performed) audit or nonaudit services that the audit committee has not preapproved? [SEC Regulation S-X Rule 2-01(c)(7)]

Yes ☐ No ☐

12. Excludes persons who are in financial reporting oversight roles solely because the person served on the client's board of directors, board committee, or similar governance body.

*Q50. Has the accounting firm had the required communications with the audit committee regarding independence? [PCAOB Rule 3526, Communication with Audit Committees Concerning Independence (AICPA, PCAOB Standards and Related Rules, Rules of the Board, "Rules")] Also see questions 6–7 under the heading "Audit Committee Pre-approval" in Office of the Chief Accountant: Application of the Commission's Rules on Auditor Independence—Frequently Asked Questions (issued August 6, 2007).<sup>13</sup>*

Yes ☐ No ☐

*Q51. Has the accounting firm provided tax services that did not meet PCAOB preapproval requirements for permitted tax services? [PCAOB Rule 3524, Audit Committee Pre-approval of Certain Tax Services (AICPA, PCAOB Standards and Related Rules, Rules of the Board, "Rules")]*

Yes ☐ No ☐

*Q52. Has the accounting firm provided internal control-related services that did not meet PCAOB preapproval requirements for permitted internal control-related services? [PCAOB Rule 3525, Audit Committee Pre-approval of Non-audit Services Related to Internal Control Over Financial Reporting (AICPA, PCAOB Standards and Related Rules, Rules of the Board, "Rules")]*

Yes ☐ No ☐

*Q53. Has the accounting firm prepared the audit client's eXtensible Business Reporting Language (XBRL) taxonomy and specifications or made decisions about those documents on behalf of management? [question 6 of PCAOB staff questions and answers Attest Engagements Regarding XBRL Financial Information Furnished Under the XBRL Voluntary Financial Reporting Program on the EDGAR System (issued May 25, 2005)] Also see appendix C for the URL to this PCAOB staff questions and answers document.*

Yes ☐ No ☐

<sup>13</sup> PCAOB Rule 3526, Communication with Audit Committees Concerning Independence (AICPA, PCAOB Standards and Related Rules, Rules of the Board, "Rules"), supersedes the PCAOB's existing interim standard, Independence Standards Board Standard No. 1, Independence Discussions with Audit Committees (AICPA, PCAOB Standards and Related Rules, PCAOB Standards, As Amended, "Independence Standards Board"), and its interpretations. Auditors must comply with PCAOB Rule 3526 before accepting a new audit engagement and annually thereafter. The rule went into effect on September 30, 2008.

## Category 4: Fee Arrangements

.25 The following are important points:

- ▶ The time period you should consider for purposes of these questions is the *period of the professional engagement* and the period covered by the financial statements.
- ▶ The term audit client, as used in the SEC independence rules, includes an affiliate of the audit client (see appendix B).

Q1. Except for a *client* that is currently in bankruptcy, does or will the *client* owe fees to the *firm* for services rendered more than one year prior to the date of the current year's report? [ET sec. 191 par. .103–.104]

Yes ☐ No ☐

Q1a. Does the audit client owe the accounting firm fees from previously rendered services for an extended period of time that are material in relation to the current year audit engagement? [SEC Codification of Financial Reporting Policies, "Independence Matters," Section 602.02.b.iv, "Unpaid Prior Professional Fees"]

Yes ☐ No ☐

Q2. Did or will the *firm* provide any of the following attest services to the *client*: (a) financial statement audit or review; (b) financial statement compilation in which the *member* expects, or might reasonably expect, third-party reliance and the *member* did not disclose a lack of independence in the report; or (c) an examination of prospective financial information? [ET sec. 302 par. .01] (If the answer is "No," skip questions 3–7.)

Yes ☐ No ☐

Q3. Did the *firm* also provide any service, other than tax services, for a *contingent fee* that was not fixed by a court or other public authority? [ET sec. 302 par. .01]

Yes ☐ No ☐

Q4. Did the *firm* provide tax services to the *client* for a *contingent fee* when the *firm* did not expect that the fee would be determined based on the results of judicial proceedings or the findings of governmental agencies (that is, you could not demonstrate a reasonable expectation, at the time of the arrangement, that the result of your work would be substantively reviewed by an agency)? [ET sec. 302 par. .02]

Yes ☐ No ☐

Q5. Did the *firm* sell goods or services to the *client* for a *commission*? [ET sec. 503 par. .01]

Yes ☐ No ☐

Q6. Did the *firm* receive a *commission* for recommending or referring the *client* to a third party to purchase goods or services (excluding services provided by a CPA)? [ET sec. 503 par. .01]

Yes ☐ No ☐

Q7. Did the *firm* receive a *commission* for recommending or referring a third party to the *client* to purchase goods or services (excluding services provided by a CPA)? [ET sec. 503 par. .01]

Yes ☐ No ☐

Q8. Did the accounting firm provide a product or service to the audit client for a commission or contingent fee or receive a commission or contingent fee either directly from the audit client or indirectly from a party other than the audit client?<sup>14</sup> [PCAOB Rule 3521, Contingent Fees (AICPA, PCAOB Standards and Related Rules, *Rules of the Board*, "Rules")]

Yes ☐ No ☐

Q9. If your accounting firm has 10 or more partners or 5 or more audit clients that are issuers, did an audit partner (other than a specialty partner) earn or receive compensation based on selling nonaudit services to the audit client? [SEC Regulation S-X, Rule 2-01(c)(8)]

Yes ☐ No ☐ N/A ☐

## Category 5: Miscellaneous

.26 Considerations and follow-up for items falling into the miscellaneous category will vary but are similar to categories 1–4. The following are important points:

- ▶ The time period you should consider for purposes of these questions is the *period of the professional engagement* and the period covered by the financial statements.
- ▶ Unless noted otherwise, the term audit client, as used in the SEC independence rules, includes an affiliate of the audit client (see appendix B).

<sup>14</sup> Excludes a contingent fee that was determined by a court or other public authority acting in the public interest that was not contingent upon the findings or results of the accounting firm's services.



Q1. Does the engagement letter for this audit or other attest service include a provision that indemnifies the *client* for damages, losses, or costs arising from lawsuits, claims, or settlements that relate, directly or indirectly, to *client* acts? [ET sec. 191 par. .204–.205]

Yes ☐ No ☐

*Q1a. Do the accounting firm and the audit client have an agreement whereby the client would indemnify the accounting firm for any losses, claims, damages, or liabilities the firm may incur as a result of litigation with the audit client related to the engagement, including provisions that indemnify the firm for losses relating to knowing misrepresentations by audit client management? [SEC Codification of Financial Reporting Policies, “Independence Matters,” Section 602.02.f.i, “Indemnification by Client”; question 4 under the heading “Other Matters” in Office of the Chief Accountant: Application of the Commission’s Rules on Auditor Independence—Frequently Asked Questions (issued December 13, 2004)]<sup>15</sup>*

Yes ☐ No ☐

*Q1b. Do the accounting firm and the audit client have an agreement whereby the accounting firm’s liability is limited to a certain dollar amount in the event the firm is found to be liable for losses, claims, or damages related to the engagement?<sup>16</sup>*

Yes ☐ No ☐

Q2. Has there been any actual or threatened litigation between the *client* (or its management) that has placed the *firm* or a *covered member* and the *client* at material adverse interests? [ET sec. 101 par. .08]

Yes ☐ No ☐

*Q2a. Has there been any actual or threatened litigation between the accounting firm and the audit client regarding audit or other attestation work that has caused the relationship between the firm and the client to become adversarial? [SEC Codification of Financial Reporting Policies, “Independence Matters,” Section 602.02.f.ii, “Litigation”]*

Yes ☐ No ☐

15. If affiliates of the accounting firm have issued separate engagement letters relating to the audits of subsidiaries, these engagement letters also should be reviewed for compliance with the rule.

16. If foreign affiliates of the accounting firm have issued separate engagement letters relating to the audits of foreign subsidiaries, these engagement letters also should be reviewed for compliance with the rule.



Q2b. Has there been any actual or threatened litigation between the accounting firm and the audit client regarding audit or other attestation work that has caused the interests of the firm and the client to be inappropriately aligned? [SEC Codification of Financial Reporting Policies, "Independence Matters," Section 602.02.f.ii, "Litigation"]

Yes ☐ No ☐

Q3. Has a *covered member* accepted entertainment (for example, dinner or tickets to a show or sporting events) from key persons or significant shareholders of the *client* or offered gifts or provided entertainment to such persons that would not be considered reasonable under the circumstances? [ET sec. 191 par. .226–.227]  
For additional guidance, see [www.aicpa.org/download/ethics/Gifts\\_Basis\\_Document.pdf](http://www.aicpa.org/download/ethics/Gifts_Basis_Document.pdf).

Yes ☐ No ☐

Q4. Has a member of the *attest engagement team* or an *individual in a position to influence the attest engagement* accepted a gift from the *attest client* whose value was not clearly insignificant to the recipient? [ET sec. 191 par. .228–.229] For additional guidance, see [www.aicpa.org/download/ethics/Gifts\\_Basis\\_Document.pdf](http://www.aicpa.org/download/ethics/Gifts_Basis_Document.pdf).

Yes ☐ No ☐

Q5. Has a member of the *firm* identified a potential conflict of interest (that is, a relationship with another person, entity, product, or service) that could be viewed by the *client* or other appropriate parties as impairing the *member's* objectivity but the potential conflict either was not disclosed to such parties or, if the relationship was disclosed, the parties did not provide their consent to perform the services? [ET sec. 102 par. .03]

Yes ☐ No ☐

Q6. If your accounting firm has 10 or more partners and 5 or more audit clients that are issuers, has a lead or concurring audit partner served on the audit engagement team for more than 5 years? [SEC Regulation S-X Rule 2-01(c)(6)]

Yes ☐ No ☐ N/A ☐

Q7. If your accounting firm has 10 or more partners or 5 or more audit clients that are issuers, has an audit partner (other than a lead or concurring audit partner or a specialty partner) served on the audit engagement

team for more than 7 years? [SEC Regulation S-X  
Rule 2-01(c)(6); question 2 under the heading “Audit  
Partner and Partner Rotation” in Office of the Chief  
Accountant: Application of the Commission’s Rules on  
Auditor Independence—Frequently Asked Questions  
(issued August 13, 2003)]

Yes ☐ No ☐ N/A ☐

.27 **Note:** The code recognizes that it is impossible to identify all circumstances in which the appearance of independence might be questioned by third parties. Interpretation No. 101-1, “Interpretation of Rule 101,” under Rule 101 (AICPA, *Professional Standards*, vol. 2, ET sec. 101 par. .02), requires that *members* use the approach described in ET section 100.01, *Conceptual Framework for AICPA Independence Standards* (AICPA, *Professional Standards*, vol. 2), (the framework) when making decisions about matters that are not specifically addressed in the independence interpretations and rulings in the code. The framework primarily requires the *member* to analyze interests and relationships in light of “threats and safeguards” to independence. Specifically, if threats to independence are unacceptable, safeguards should be applied (for example, by removing a *member* from the engagement team or performing a second review of a *member’s* work) to eliminate threat(s) or reduce them to an acceptable level. If threats to independence are eliminated or reduced by safeguards, the *member* should document the matter.

## Part II: Resolution of Potential Independence Issues

.28 Please review the following categories carefully for any “Yes” response you provided and for any questions that you were unable to answer in the questionnaire. For each of the five categories, we suggest several types of information you may wish to consider in evaluating your compliance with the independence rules. These suggestions are intended to help you gather and analyze the information.

.29 **Note:** Some suggested items may be relevant for evaluating certain matters but not others. For example, materiality of a *covered member’s direct financial interest* in an *audit client* would not be considered relevant in determining whether the interest was deemed to impair independence under the AICPA and SEC rules. You should refer directly to the code and, when applicable, the SEC and PCAOB independence rules for specific information.

.30 If, based on your evaluation, you determine that an independence matter needs to be resolved, the *member* should document the matter. An illustration of how to do this appears in appendix D, “Documenting Independence Matters.”

## Category 1: Personal Financial Interests and Relationships

.31 Prohibitions on personal financial interests and relationships apply during the *period of the professional engagement*; hence, caught early, timely actions may avoid an independence issue.

.32 For matters involving *financial interests*, the following facts, though not all-inclusive, should be gathered and considered:

- ▶ The nature of the *financial interest* or relationship
- ▶ The applicable time period(s) (for example, the *period of the professional engagement* and how long the interest was held)
- ▶ When the individual became a *covered member* (or *covered person*) and why he or she is a *covered member* (or *covered person*) under the rules
- ▶ The nature of the attest work (for example, audit, review, or agreed-upon procedures)<sup>17</sup>
- ▶ Who was aware of the *financial interest* and when they became aware of it
- ▶ Whether the interest is a(n) *direct* or *indirect financial interest* (see appendix A)
- ▶ Whether a *financial interest* is indirect or, if otherwise provided for in the rules, whether the interest was material to the net worth of the individual(s) involved
- ▶ Whether the interest was held in a retirement or similar employee benefit plan, whether the plan participant is the *covered member* or his or her *immediate family*, and whether the plan participant is currently employed by the plan sponsor
- ▶ Whether the interest arose as a result of an unsolicited inheritance or gift (see Interpretation No. 101-15, “Financial Relationships,” under Rule 101 [AICPA, *Professional Standards*, vol. 2, ET sec. 101 par. .17])

.33 For matters involving *loans*, the following facts, though not all-inclusive, should be gathered and considered:

- ▶ When the *loan* was obtained and by whom
- ▶ Whether the *loan* was obtained from a *financial institution*
- ▶ Whether the *loan* was obtained from the *client* or from a person or entity associated with the *client* (for example, officer, director, significant shareholder, or nonclient parent corporation)

17. See appendix E, “Modified AICPA Independence Requirements for Certain Statements on Standards for Attestation Engagements,” for specific guidance on agreed-upon procedures engagements.

- ▶ Whether the borrower was a *covered member* (or *covered person*) at the time the *loan* was obtained
- ▶ Whether the lender was an attest *client* when the *loan* was obtained
- ▶ Whether the *loan* met requirements for grandfathering
- ▶ The type of *loan*
- ▶ Specifics surrounding *loan* renewals and revisions
- ▶ Whether the *loan* is secured by property or other assets and, if so, the proportion of the *loan* that is secured and whether the unsecured portion is material to the *covered member's* net worth

.34 The following are possible follow-up actions:

- ▶ Remove from the engagement team the individual whose interest or relationship caused the independence issue
- ▶ Dispose of the *financial interest* or relationship (for example, the *loan* or checking account) that caused the independence issue
- ▶ Discuss the matter with the *client's* governance board (for example, the board of directors, *those charged with governance*, or other equivalent body) to determine the board's views on the appearance of independence
- ▶ Review the work of the individual whose interest or relationship caused an independence issue
- ▶ Repperform the audit procedures performed by an individual deemed to have caused the independence issue
- ▶ Decline to perform the audit for the affected period(s)
- ▶ When appropriate, consider AU section 561, *Subsequent Discovery of Facts Existing at the Date of the Auditor's Report* (AICPA, *Professional Standards*, vol. 1)

## Category 2: Employment and Business Relationships

.35 Employment and business relationships are prohibited during the *period of the professional engagement* and the period covered by the financial statements. Restrictions on employment and business relationships also generally apply to more people in the *firm* (that is, all *partners* and professional staff) than the restrictions on financial interests and relationships, which, with some exceptions, apply only to *covered members* (or *covered persons*) and certain family members. As such, issues arising from employment and business relationships can be more difficult to address than issues arising from financial interests

and relationships. The following facts, though not all-inclusive, should be gathered and considered:

- ▶ The nature of the employment or business relationship
- ▶ Individuals who held (hold) positions in the *client* and their relationship to the *firm* or a member of the *firm*
- ▶ If a relative has an employment or business relationship with the *client*, the nature of the relationship with the *firm* member and the *member's* position in the firm
- ▶ The applicable time frames (for example, the *period of the professional engagement*, the period covered by financial statements, or the period of the employment or business relationship)
- ▶ For former *partners* or professional staff, actions taken to disassociate from the *firm*
- ▶ For former *partners* or professional staff of the *firm*, pending relationships with the *firm*
- ▶ For persons formerly associated with the *client*, actions taken to disassociate from the *client*
- ▶ For persons formerly associated with the *client*, pending interests or relationships with the *client*
- ▶ *Whether a business relationship was limited to purchasing goods or services from the audit client in an arm's length transaction*
- ▶ *For persons in the accounting firm who accepted employment with an audit client and may be subject to the "cooling off" provision, the following facts, though not all-inclusive, should be gathered and considered:*
  - *A description of the position assumed and the position's impact on the consolidated financial statements of the audit client*
  - *The individual's role on the audit engagement team (for example, the lead or concurring partner)*
  - *Other than the lead and concurring review partners, the amount of time spent on the audit engagement team*
  - *Dates the individual served on the audit engagement team and in what capacity*
  - *The applicable SEC filing dates (quarterly and annual report dates) covering the individual's service on the audit engagement team and employment with the audit client*
  - *Whether the individual became employed by the audit client or an affiliate of the audit client*

- *Whether the employment resulted from a merger or acquisition that was not contemplated by the individual*
- *When the individual became employed by the audit client*
- *Whether the matter has been discussed with the audit committee and, if so, a description of that discussion*

.36 The following are possible follow-up actions:

- ▶ Cease the employment or business relationship that caused the independence issue
- ▶ Discuss the matter with the *client's* governance board (for example, the board of directors, *those charged with governance*, or other equivalent body) to determine the board's views on the appearance of independence
- ▶ Review the work of the individual whose relationship caused the independence issue
- ▶ Reperform audit procedures performed by an individual deemed to have caused the independence issue
- ▶ Decline to perform the audit for the affected period(s)
- ▶ When appropriate, consider AU section 561
- ▶ *Discuss the matter with the audit client's governance board (for example, the board of directors, audit committee, or other equivalent body) to determine whether, due to an emergency or other unusual situation, it is in the best interest of investors to permit the employment [SEC Release No. 33-8183, Strengthening the Commission's Requirements Regarding Auditor Independence, Section II, "Discussion of Rules"]*

### Category 3: Nonattest Services Engagements

.37 Like employment and business relationships, restrictions on certain nonattest services apply during the *period of the professional engagement* and the period covered by the financial statements. The following facts, though not all-inclusive, should be gathered and considered:

- ▶ The nature of the work or other activities performed
- ▶ The nature of the attest work (for example, audit, review, or agreed-upon procedures)<sup>18</sup>

18. See appendix E for specific guidance on agreed-upon procedures engagements.

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- ▶ Whether the nonattest services were performed before the entity became an attest *client* (see the FAQ included in appendix F of this practice aid under the heading “Period of the Professional Engagement”)
  - ▶ The applicable time frames (for example, the *period of professional engagement*, the period covered by the financial statements, and the period during which prohibited services or activities were performed)
  - ▶ The individuals who performed the services or activities and their relationship, if any, to the *attest engagement team*
  - ▶ The *client* designee assigned to oversee the *firm’s* work; their title; and a description of their skills, knowledge, and/or experience
  - ▶ Whether an agreement on the *firm’s* and the *client’s* respective roles was reached prior to performing the services
  - ▶ Whether an agreement on the *firm’s* and the *client’s* respective roles was documented prior to performing the services
  - ▶ *Whether for the following nonaudit services (bookkeeping, internal audit outsourcing, appraisal, valuation and actuarial, and financial information systems design and implementation)*
    - *services were provided to the audit client or an affiliate of the audit client, and*
    - *if services were provided to an affiliate of the audit client, it is reasonable to conclude that the results of these services would not be subject to audit procedures during the audit of the client’s financial statements [SEC Regulation S-X Rule 2-01(c)(4); question 4 (issued August 13, 2003) and question 7 (issued August 6, 2007) under the heading “Prohibited and Non-audit Services” in Office of the Chief Accountant: Application of the Commission’s Rules on Auditor Independence—Frequently Asked Questions]*
  - ▶ *Whether services or other activities performed for the audit client were inconsistent with the principles underlying the SEC independence rules (that is, created a mutual or conflicting interest between the accounting firm and the audit client, placed the accounting firm in a position in which it subsequently audited its own work, resulted in the accounting firm acting as management or an employee of the audit client, or placed the accounting firm in a position in which it acted as an advocate for the audit client)*
  - ▶ *With regard to personal tax services provided to persons in financial reporting oversight roles, the following facts, though not all-inclusive, should be gathered and considered:*
    - *A description of the person’s position with the audit client*
    - *The effect of the person’s responsibilities, if any, on the audit client’s consolidated financial statements*
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- *Whether the person was in a financial reporting oversight role solely because he or she was a member of the board of directors or a committee of the board*
- *Whether the person was in a financial reporting oversight role solely for a hiring, promotion, or other employment event and, if so, the applicable time frames*
- *The nature of the services provided by the accounting firm*
- ▶ *With regard to legal services, whether services that were provided to audit clients residing outside the United States satisfied criteria in the SEC staff's guidance on applying the SEC independence rules [question 1 under the heading "Prohibited and Non-audit Services" in Office of the Chief Accountant: Application of the Commission's Rules on Auditor Independence—Frequently Asked Questions (issued January 16, 2001)]*
- ▶ *With regard to services relating to tax transactions, the following facts, though not all-inclusive, should be gathered and considered:*
  - *A description of the tax service*
  - *A description of the tax transaction*
  - *A description of the terms relating to the transaction (for example, confidentiality)*
  - *Whether the transaction was marketed by an entity other than the accounting firm and, if so, a description of the relationship and the financial arrangement between the accounting firm and the other entity*
  - *Whether the tax transaction is a "listed transaction" (or is substantially similar to a "listed transaction") that has been publicized by the IRS and, if so, the publication date of the listing and when the accounting firm became aware of the listing*
  - *Whether the accounting firm concluded at the time the services were performed that the transaction met the "more likely than not" standard described in the Internal Revenue Code*
- ▶ *Whether services requiring preapproval met criteria for a waiver [SEC Regulation S-X Rule 2-01(c)(7)(i)(C)]*
- ▶ *With regard to tax or internal control-related services that were not preapproved in accordance with PCAOB Rules 3524 and 3525, respectively, a description of the procedures followed by the accounting firm in obtaining preapproval for the applicable services*

.38 The following are possible follow-up actions:

- ▶ Cease performing the prohibited services or activities
- ▶ Discuss the matter with the *client's* governance board (for example, the board of directors, *those charged with governance*, or other equivalent body) to determine



the board's views on the matter, especially with respect to the appearance of independence

- ▶ Decline to perform the audit (or other attest) engagement for the affected period(s)
- ▶ Have an independent third party reperform the nonattest services that gave rise to an independence issue<sup>19</sup>
- ▶ When appropriate, consider AU section 561

## Category 4: Fee Arrangements

### Unpaid Fees

.39 An AICPA ethics ruling states that fees outstanding for any previously rendered professional services exceeding 12 months that remain unpaid at the date of the attest report impair independence. To address fee-related issues, consider the following facts (*Note:* These are not all-inclusive.):

- ▶ The magnitude of the fees to the *client* and the *firm*
- ▶ The length of time the fees have been outstanding
- ▶ Whether the *client* has the financial means and is willing to pay the outstanding fees in full prior to the issuance of the report
- ▶ Whether the *client* has committed to pay the prior year fees in full prior to the issuance of the current year report
- ▶ Whether the *firm* is willing to compromise on previously owed amounts, including forgiving the debt in full
- ▶ *Whether unpaid fees for previously rendered services are material in relation to the fee expected to be paid for the current year audit*
- ▶ *The type of attest engagement involved (for example, routine audit or review or registration of securities)*
- ▶ *Whether the accounting firm is reasonably assured that the audit client has committed to pay current year fees in full before next year's audit engagement is commenced*

19. Readers should note that the AICPA and SEC independence rules contain no provisions relating to reperformance of prohibited nonaudit services. Such actions are best considered in concert with the client's governance committee and advice of the appropriate regulatory or standard-setting bodies.

.40 The following are possible follow-up actions:

- ▶ Obtain assurance from the *client* that all fees will be paid in full prior to the issuance of the report for the current year
- ▶ Forgive all or part of the *client's* fees to enable the *attest engagement* to be performed (provided no balance will remain by the time the attest report is issued)
- ▶ Decline to perform the current year *attest engagement* due to the continuing existence of unpaid fees that will not be resolved by the report date
- ▶ When appropriate, consider AU section 561
- ▶ *Obtain commitment from the audit client to pay current year audit fees in full before next year's audit engagement is commenced*

### Commissions and Contingent Fees

.41 The AICPA prohibition on *commissions* and *contingent fees* applies during the period in which a *member* or *member's firm* is engaged to perform any of the four listed services and the period covered by any historical financial statements involved in any of the four listed services. SEC rules prohibit both *commissions* and *contingent fees*, whether received directly from the *audit client* or indirectly from a party other than the *audit client* during the same period. The SEC rules also apply to any *audit client* (that is, a *client* for whom the *accounting firm* provides audit, review, or any attest services). The following facts, though not all-inclusive, should be gathered and considered:

- ▶ The applicable time period(s)
- ▶ The nature of the service (for example, audit or review of financial statements or other listed service)
- ▶ The specific terms of the fee arrangement, such as a description of the contingency event; the parties involved; or, for a *commission* arrangement, the name of the purchaser or supplier of the product or service and a description of the *client* relationship
- ▶ If the *contingent fee* was or will be fixed by the courts or another public authority, a description of the specific details
- ▶ Whether at the time the fee arrangement was made the *member* or *member's firm* had a reasonable expectation that the fees related to a tax matter would be determined on the basis of judicial proceedings or the findings of a governmental agency, and the justification for such expectation
- ▶ Whether services relating to the fee arrangement have already been provided
- ▶ *Whether fees were paid directly (for example, by the audit client) or indirectly (for example, by a party or entity other than the audit client)*

.42 The following are possible follow-up actions:

- ▶ Restructure the *contingent fee* arrangement so that it is not contingent (for example, set a fixed fee for the engagement or a fixed hourly rate plus expenses), as defined in ET section 302, *Contingent Fees* (AICPA, *Professional Standards*, vol. 2)
- ▶ Cancel *commission* agreements involving an attest *client* purchaser or an attest *client* supplier
- ▶ Decline to perform the services outlined in ET section 302 and ET section 503, *Commissions and Referral Fees* (AICPA, *Professional Standards*, vol. 2), covering the period of any historical financial statements during which prohibited *commissions* or *contingent fees* were received
- ▶ Discuss the matter with the *client's* governance board (for example, the board of directors, *those charged with governance*, or other equivalent body) to determine the board's views on the matter, especially with respect to the appearance of independence
- ▶ When appropriate, consider AU section 561
- ▶ *Decline to perform the audit, review, or other attest engagement for the affected period(s)*

### Partner Compensation

.43 The following facts, though not all-inclusive, should be gathered and considered:

- ▶ *Whether or not the audit client is an issuer, which may exempt the engagement from partner rotation and compensation requirements [question 1 under the heading "Broker-Dealer and Investment Advisers" in Office of the Chief Accountant: Application of the Commission's Rules on Auditor Independence—Frequently Asked Questions (issued August 13, 2003)]*
- ▶ *A description of any arrangements to compensate audit partners that are tied to selling nonaudit services*
- ▶ *Whether the partner meets the definition of audit partner in the SEC independence rules [SEC Regulation S-X Rule 2-01(c)(8)]*

.44 The following are possible follow-up actions:

- ▶ *Amend partner compensation practices to be consistent with SEC independence rules*
- ▶ *Discuss the matter with the client's governance board (for example, the board of directors, audit committee, or other equivalent body) to determine the board's views on the matter, especially with respect to the appearance of independence*

- ▶ *Decline to perform the audit (or other attest) engagement for the affected period(s)*
- ▶ When appropriate, consider AU section 561

## Category 5: Miscellaneous

.45 Considerations and follow-up for items falling into the miscellaneous category will vary but are similar to categories 1–4. Additional follow-up actions, though not all-inclusive, include the following:

- ▶ With regard to any indemnification or limitation of liability agreements to limit the auditor's liability in connection with an audit or other *attest engagement*, revoke the indemnification or limitation of liability provision.
- ▶ Gifts given to the auditor from the *client* can be returned to the *client*. Alternatively, the *client* can be reimbursed for gifts or entertainment.
- ▶ With regard to conflicts of interest, if services have not yet been performed or completed, discuss the matter with the appropriate parties and request their consent to perform or continue performing the services.
- ▶ Discuss conflicts of interest matters with the *client's* governance board (for example, the board of directors, *those charged with governance*, or other equivalent body) to determine the board's views on the matter, especially with respect to the appearance of independence.
- ▶ Decline to perform the audit (or other attest) engagement for the affected period(s).
- ▶ When appropriate, consider AU section 561.

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## APPENDIX A: AICPA Independence Terms

**attest engagement.** An attest engagement is an engagement that requires independence, as defined in *AICPA Professional Standards*.

**attest engagement team.** The attest engagement team consists of individuals participating in the attest engagement, including those who perform concurring and second-partner reviews. The attest engagement team includes all employees and contractors retained by the firm who participate in the attest engagement, irrespective of their functional classification (for example, audit, tax, or management consulting services). The attest engagement team excludes specialists, as discussed in AU section 336, *Using the Work of a Specialist* (AICPA, *Professional Standards*, vol. 1), and individuals who perform only routine clerical functions, such as word processing and photocopying.

**client.** A client is any person or entity, other than the member's employer, that engages a member or a member's firm to perform professional services or that engages a person or entity with respect to which professional services are performed. For purposes of this paragraph, the term *employer* does not include the following:

- ▶ Entities engaged in the practice of public accounting
- ▶ Federal, state, and local governments or component units thereof, provided the member performing professional services with respect to those entities
  - is directly elected by voters of the government or component unit thereof with respect to the professional services that are performed.
  - is an individual who is (1) appointed by a legislative body and (2) subject to removal by a legislative body.
  - is appointed by someone other than the legislative body, so long as the appointment is confirmed by the legislative body and removal is subject to oversight or approval by the legislative body.

**close relative.** A close relative is a parent, sibling, or nondependent child.

**commission.** A commission is any compensation for recommending or referring a product or service to a third party. The term *commission* excludes a referral fee paid for the services of a CPA to any person.

**contingent fee.** A contingent fee is a fee established for the performance of any service pursuant to an arrangement in which no fee will be charged unless a specified finding or result is attained or in which the amount of the fee is otherwise dependent upon the finding or result of such service.

**covered member.** A covered member is

- ▶ an individual on the attest engagement team.
- ▶ an individual in a position to influence the attest engagement.
- ▶ a partner or manager who provides nonattest services to the attest client beginning once he or she provides 10 hours of nonattest services to the client within any fiscal year and ending on the later of the date (a) the firm signs the report on the financial statements for the fiscal year during which those services were provided or (b) he or she no longer expects to provide 10 or more hours of nonattest services to the attest client on a recurring basis.
- ▶ a partner in the office in which the lead attest engagement partner primarily practices in connection with the attest engagement.
- ▶ the firm, including the firm's employee benefit plans.
- ▶ an entity whose operating, financial, or accounting policies can be controlled (as defined by generally accepted accounting principles [GAAP] for consolidation purposes) by any of the individuals or entities described herein as a covered member or by two or more such individuals or entities if they act together.

**dependent.** Generally, a dependent is an individual who receives more than half of his or her financial support from the covered member.

**direct financial interest.** A direct financial interest is

- ▶ owned directly by an individual or entity (including those managed on a discretionary basis by others).
- ▶ under the control<sup>1</sup> of an individual or entity (including those managed on a discretionary basis by others).
- ▶ beneficially owned through an investment vehicle, estate, trust, or other intermediary when the beneficiary

1. For purposes of this definition, the term *control* includes situations in which the covered member, individually or acting together with his or her firm, other partners, or professional employees, has the ability to exercise such control.

- controls the intermediary or
- has the authority to supervise or participate in the intermediary's investment decisions.

A financial interest is beneficially owned if an individual or entity is not the record owner of the interest but has a right to some or all of the underlying benefits of ownership. These benefits include the authority to direct the voting or the disposition of the interest or to receive the economic benefits of the ownership of the interest.

**diversified mutual fund.** A diversified mutual fund is a mutual fund that meets the requirements of Section 5(b)(1) of the Investment Company Act of 1940. In addition, a mutual fund's prospectus will indicate if a fund is not diversified and may be used to determine whether a mutual fund is a diversified mutual fund meeting the criteria of the Investment Company Act of 1940.

**financial institution.** A financial institution is considered to be an entity that, as part of its normal business operations, makes loans or extends credit to the general public. In addition, for automobile leases addressed under Interpretation No. 101-5, "Loans From Financial Institution Clients and Related Terminology," under Rule 101, *Independence* (AICPA, *Professional Standards*, vol. 2, ET sec. 101 par. .07), an entity would be considered a financial institution if it leases automobiles to the general public.

**financial interest.** A financial interest is an ownership interest in an equity or a debt security issued by an entity, including rights and obligations to acquire such an interest and derivatives directly related to such interest.

**firm.** A firm is a form of organization permitted by law or regulation that is engaged in the practice of public accounting and whose characteristics conform to resolutions of the council of the AICPA. Except for purposes of applying Ethics Rule 101, the firm includes the individual partners thereof.

**grandfathered loan.** Grandfathered loans are unsecured loans that are not material to the covered member's net worth. Home mortgages and other secured loans are grandfathered if

- ▶ they were obtained from a financial institution under that institution's normal lending procedures, terms, and requirements.
- ▶ after the borrower becomes a covered member, they are kept current concerning all terms at all times and those terms do not change in any manner not provided for in the original loan agreement.



- ▶ they were obtained from a financial institution
  - prior to its becoming a client requiring independence.
  - for which independence was not required and were later sold to a client for which independence is required.
- ▶ they complied with the applicable independence requirements in place at the time the loan was obtained.

**immediate family.** Immediate family is a spouse, spousal equivalent, or dependent (whether or not related).

**indirect financial interest.** An indirect financial interest is a financial interest beneficially owned through an investment vehicle, estate, trust, or other intermediary, such that the beneficiary neither controls the intermediary nor has the authority to supervise or participate in the intermediary's investment decisions.

A financial interest is beneficially owned if an individual or entity is not the record owner of the interest but has a right to some or all of the underlying benefits of ownership. These benefits include the authority to direct the voting or the disposition of the interest or to receive the economic benefits of the ownership of the interest.

**individual in a position to influence the attest engagement.** An individual in a position to influence the attest engagement is one who

- ▶ evaluates the performance or recommends the compensation of the attest engagement partner.
- ▶ directly supervises or manages the attest engagement partner, including all successively senior levels above that individual through the firm's chief executive.
- ▶ consults with the attest engagement team regarding technical or industry-related issues specific to the attest engagement.
- ▶ participates in or oversees, at all successively senior levels, quality control activities, including internal monitoring with respect to the specific attest engagement.

**joint closely held investment.** A joint closely held investment is an investment in an entity or property by the member and the client (or the client's officers or directors or any owner who has the ability to exercise significant influence over the client) that enables them to control (as defined by GAAP for consolidation purposes) the entity or property.

**key position.** A key position is a position in which an individual

- ▶ has primary responsibility for significant accounting functions that support material components of the financial statements.
- ▶ has primary responsibility for the preparation of the financial statements.
- ▶ has the ability to exercise influence over the contents of the financial statements, including when the individual is a member of the board of directors or similar governing body, chief executive officer, president, chief financial officer, chief operating officer, general counsel, chief accounting officer, controller, director of internal audit, director of financial reporting, treasurer, or any equivalent position.

For purposes of attest engagements not involving a client's financial statements, a key position is one in which an individual is primarily responsible for or able to influence the subject matter of the attest engagement, as previously described.

**loan.** A loan is a financial transaction, the characteristics of which generally include, but are not limited to, an agreement that provides repayment terms and a rate of interest. A loan includes, but is not limited to, a guarantee of a loan, a letter of credit, a line of credit, or a loan commitment.

**manager.** A manager is a professional employee of the firm who has either of the following responsibilities:

- ▶ Continuing responsibility for the overall planning and supervision of engagements for specified clients
- ▶ Authority to determine that an engagement is complete, subject to final partner approval if required

**member.** A member, associate member, or international associate of the AICPA.

**normal lending procedures, terms, and requirements.** *Normal lending procedures, terms, and requirements* relating to a covered member's loan from a financial institution are defined as lending procedures, terms, and requirements that are reasonably comparable with those relating to loans of a similar character committed to other borrowers during the period the loan to the covered member is committed. Accordingly, in making such comparison and evaluating whether a loan was made under "normal lending procedures, terms, and requirements," the covered member should consider all the circumstances under which the loan was granted, including the following:

- ▶ The amount of the loan in relation to the value of the collateral pledged as security and the credit standing of the covered member
- ▶ Repayment terms
- ▶ Interest rate, including “points”
- ▶ Closing costs
- ▶ General availability of such loans to the public

Related prohibitions that may be more restrictive are prescribed by certain state and federal agencies having regulatory authority over such financial institutions. Broker-dealers, for example, are subject to regulation by the Securities and Exchange Commission.

**office.** An office is a reasonably distinct subgroup within a firm, whether constituted by formal organization or informal practice, in which personnel who make up the subgroup generally serve the same group of clients or work on the same categories of matters. Substance should govern the office classification. For example, the expected regular personnel interactions and assigned reporting channels of an individual may well be more important than an individual’s physical location.

**partner.** A partner is a proprietor, shareholder, equity or nonequity partner of the firm, or any individual who assumes the risks and benefits of firm ownership or who is otherwise held out by the firm to be the equivalent of any of the aforementioned.

**period of the professional engagement.** The period of the professional engagement begins when a member either signs an initial engagement letter or other agreement to perform attest services or when a member begins to perform an attest engagement for a client, whichever is earlier. The period lasts for the entire duration of the professional relationship (which could cover many periods) and ends with the formal or informal notification by either the member or the client of the termination of the professional relationship or by the issuance of a report, whichever is later. Accordingly, the period does not end with the issuance of a report and recommence with the beginning of the following year’s attest engagement.

**permitted loan.** Permitted loans are the following new loans and leases obtained from a financial institution client. These loans and leases must be obtained under the institution’s normal lending procedures, terms, and requirements and must, at all times, be kept current concerning all terms, such as the following:

- ▶ Automobile loans and leases collateralized by the automobile

- ▶ Loans fully collateralized by the cash surrender value of an insurance policy
- ▶ Loans fully collateralized by cash deposits at the same financial institution (for example, “passbook loans”)
- ▶ Aggregate outstanding balances from credit cards and overdraft reserve accounts that are reduced to \$10,000 or less on a current basis taking into consideration the payment due date and any available grace period

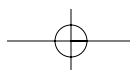
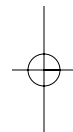
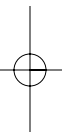
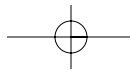
**significant influence.** The term *significant influence* is as defined in Accounting Principles Board Opinion No. 18, *The Equity Method of Accounting for Investments in Common Stock*, and its interpretations.<sup>2</sup>

**source document.** Source documents are the documents upon which the evidence of an accounting transaction is initially recorded. Source documents are often followed by the creation of many additional records and reports, which do not, however, qualify as initial recordings. Examples of source documents are purchase orders, payroll time-cards, and customer orders.

**spousal equivalent.** A spousal equivalent designation should be made on a case-by-case basis considering factors such as the nature of the relationship, living and financial arrangements, and whether a common-law marriage exists. However, it should be noted that the lack of a common-law marriage under state law (or the lack of such law recognizing common-law marriages in an individual’s state of residence) does not mean that an individual is not a spousal equivalent if other factors lead to that conclusion.

**those charged with governance.** *Those charged with governance*, as defined by AU section 380, *The Auditor’s Communication With Those Charged With Governance* (AICPA, *Professional Standards*, vol. 1), means the person(s) with responsibility for overseeing the strategic direction of the entity and obligations related to the accountability of the entity. This includes overseeing the financial reporting process. In some cases, those charged with governance are responsible for approving the entity’s financial statements (in other cases management has this responsibility). For entities with a board of directors, this term encompasses the term *board of directors* or *audit committee* used elsewhere in generally accepted auditing standards.

<sup>2</sup> At the time of this writing, the Financial Accounting Standards Board (FASB) was expected to make the FASB *Accounting Standards Codification*<sup>TM</sup> (FASB ASC) authoritative effective July 1, 2009. Accounting Principles Board Opinion No. 18, *The Equity Method of Accounting for Investments in Common Stock*, has been codified at FASB ASC 323, *Investments—Equity Method and Joint Ventures*, and FASB ASC 325, *Investments—Other*.



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## APPENDIX B: SEC Independence Terms

**accountant.** A registered public accounting firm, CPA, or public accountant performing services in connection with an engagement for which independence is required. References to the accountant include any accounting firm with which the CPA or public accountant is affiliated.

**accounting firm.** An organization (whether it is a sole proprietorship, incorporated association, partnership, corporation, limited liability company, limited liability partnership, or other legal entity) that is engaged in the practice of public accounting and furnishes reports or other documents filed with the Securities and Exchange Commission (SEC) or otherwise prepared under the securities laws. The accounting firm also includes all of the organization's departments, divisions, parents, subsidiaries, and associated entities, including those located outside of the United States. In addition, the organization's pension, retirement, investment, or similar plans are considered part of the accounting firm.

**accounting role.** A role in which a person is in a position to exercise or does exercise more than minimal influence over the contents of the accounting records or anyone who prepares them.

**affiliate of the audit client.** Affiliates are defined as the following:

- ▶ An entity that has control over the audit client or over which the audit client has control or that is under common control with the audit client, including the audit client's parents and subsidiaries
- ▶ An entity over which the audit client has significant influence, unless the entity is not material to the audit client
- ▶ An entity that has significant influence over the audit client, unless the audit client is not material to the entity
- ▶ Each entity in the investment company complex when the audit client is an entity that is part of an investment company complex

**aggressive tax position.** Aggressive tax transactions include, but are not limited to, any transaction that is a listed transaction within the meaning of Title 26, *Internal Revenue*, of the U.S. *Code of Federal Regulations* (CFR) Part 1.6011-4(b)(2). An accounting firm indirectly recommends a transaction when the firm, an affiliate of the firm, or another tax adviser with which the firm has a formal agreement or other arrangement related to the promotion of such transactions recommends engaging in the transaction.

**audit client.** The entity whose financial statements or other information is being audited, reviewed, or attested and any affiliates of the audit client.

**audit committee.** A committee (or equivalent body) as defined in section 3(a)(58) of the Securities Exchange Act of 1934 [Title 15, *Commerce and Trade*, of the U.S. *Code* (USC), Chapter 2B, Section 78c(a)(58)].

**audit engagement team.** All partners, principals, shareholders, and professional employees participating in an audit, review, or attestation engagement of an audit client, including audit partners and all persons who consult with others on the audit engagement team during the audit, review, or attestation engagement regarding technical or industry-specific issues, transactions, or events.

**audit partner.** A partner or person(s) in an equivalent position (other than a partner who consults with others on the audit engagement team during the audit, review, or attestation engagement regarding technical or industry-specific issues, transactions, or events) who is a member of the audit engagement team and either has responsibility for decision making on significant auditing, accounting, and reporting matters that affect the financial statements or maintains regular contact with management and the audit committee. An audit partner includes the following:

- ▶ The lead or coordinating audit partner having primary responsibility for the audit or review (that is, the lead partner)
- ▶ The partner performing a second level of review to provide additional assurance that the financial statements subject to the audit or review are in conformity with generally accepted accounting principles and that the audit or review and any associated report are in accordance with generally accepted auditing standards and rules promulgated by the SEC or the Public Company Accounting Oversight Board (that is, the concurring or reviewing partner)
- ▶ Other audit engagement team partners who provide more than 10 hours of audit, review, or attest services in connection with the annual or interim consolidated



financial statements of the issuer or an investment company registered under section 8 of the Investment Company Act of 1940 (Title 15 of the USC, Chapter 2D, Subchapter I, Section 80a-8)

- ▶ Other audit engagement team partners who serve as the lead partner in connection with any audit or review related to the annual or interim financial statements of a subsidiary of the issuer whose assets or revenues constitute 20 percent or more of the assets or revenues of the issuer's respective consolidated assets or revenues

**chain of command.** All persons who

- ▶ supervise or have direct management responsibility for the audit, including all successively senior levels through the accounting firm's chief executive.
- ▶ evaluate the performance or recommend the compensation of the audit engagement partner.
- ▶ provide quality control or other oversight of the audit.

**commission.** Any compensation for recommending or referring a product or service to a third party.

**confidential transaction.** In general, a confidential transaction is a transaction that is offered to a taxpayer under conditions of confidentiality and for which the taxpayer has paid a fee to an adviser.

A transaction is considered to be offered to a taxpayer under conditions of confidentiality if the adviser who is paid the fee places a limitation on disclosure by the taxpayer of the tax treatment or tax structure of the transaction and the limitation on disclosure protects the confidentiality of that adviser's tax strategies. A transaction is treated as confidential even if the conditions of confidentiality are not legally binding on the taxpayer. A claim that a transaction is proprietary or exclusive is not treated as a limitation on disclosure if the adviser confirms to the taxpayer that no limitation on disclosure of the tax treatment or tax structure of the transaction exists.

For purposes of this definition, a fee includes all fees for a tax strategy, services for advice (whether or not tax advice), or the implementation of a transaction. These fees include consideration in whatever form paid, whether in cash or in kind, for services to analyze the transaction (whether or not related to the tax consequences of the transaction), implement the transaction, document the transaction, and prepare tax returns to the extent that the fees exceed the fees customary for return preparation. For purposes

of this definition, a taxpayer also is treated as paying fees to an adviser if the taxpayer knows or should know that the amount he or she pays will be paid indirectly to the adviser, such as through a referral fee or fee-sharing arrangement. A fee does not include amounts paid to a person, including an adviser, who is a party to the transaction. For example, a fee does not include reasonable charges for the use of capital or the sale or use of property.

Persons who bear a relationship to each other as described in section 267(b) or 707(b) of the Internal Revenue Code will be treated as the same person.

**contingent fee.** Any fee established for the sale of a product or the performance of any service pursuant to an arrangement in which no fee will be charged unless a specified finding or result is attained or in which the amount of the fee is otherwise dependent upon the finding or result of such product or service. Solely for the purposes of this definition, a fee is not a contingent fee if the amount is fixed by courts or other public authorities and not dependent on a finding or result.

**covered person.** The following partners, principals, shareholders, and employees of an accounting firm are considered covered persons:

- ▶ The audit engagement team
- ▶ The chain of command
- ▶ Any other partner, principal, shareholder, or managerial employee of the accounting firm who (a) has provided 10 or more hours of nonaudit services to the audit client for the period beginning on the date such services are provided and ending on the date the accounting firm signs the report on the financial statements for the fiscal year during which those services are provided or (b) expects to provide 10 or more hours of nonaudit services to the audit client on a recurring basis
- ▶ Any other partner, principal, or shareholder from an office of the accounting firm in which the lead audit engagement partner primarily practices in connection with the audit

**financial reporting oversight role.** A role in which a person is in a position to exercise or does exercise influence over the contents of the financial statements or anyone who prepares them, such as when the person is a member of the board of directors or similar management or governing body, chief executive officer, president, chief financial officer, chief operating officer, general counsel, chief accounting officer, controller, director of internal audit, director of financial reporting, treasurer, or any equivalent position.

**investment company complex.** This includes any of the following:

- ▶ An investment company and its investment adviser or sponsor
- ▶ Any entity controlled by or controlling an investment adviser or sponsor, as described in SEC Regulation S-X Rule 2-01(f)(14)(i)(A)
- ▶ Any entity under common control with an investment adviser or sponsor, as described in SEC Regulation S-X Rule 2-01(f)(14)(i)(A) if the entity
  - is an investment adviser or sponsor
  - is engaged in the business of providing administrative, custodian, underwriting, or transfer agent services to any investment company, investment adviser, or sponsor
- ▶ Any investment company or entity that would be an investment company, except for the exclusions provided by section 3(c) of the Investment Company Act of 1940 [Title 15 of the USC, Chapter 2D, Subchapter I, Section 80a-3(c)], that has an investment adviser or sponsor included in this definition by either Rule 2-01(f)(14)(i)(A) or Rule 2-01(f)(14)(i)(B) of Regulation S-X

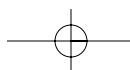
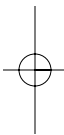
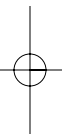
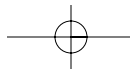
For the purposes of this definition, an investment adviser does not include a subadviser whose role is primarily portfolio management and is subcontracted with or overseen by another investment adviser.

For the purposes of this definition, a sponsor is an entity that establishes a unit investment trust.

**issuer.** An issuer is an entity whose securities are registered under section 12 of the Securities Exchange Act of 1934, that is required to file reports under section 15(d) of the Securities Exchange Act of 1934, or that files or has filed a registration statement that has not yet become effective under the Securities Exchange Act of 1934 and has not been withdrawn.

**office.** A distinct subgroup within an accounting firm, whether distinguished along geographic or practice lines.

**specialty partner.** Partners who consult with others on the audit engagement team during the audit, review, or attestation engagements regarding technical, industry, or other specific issues (for example, tax partner).



## APPENDIX C: Sources of Guidance

Readers may refer to [www.aicpa.org/Professional+Resources/Professional+Ethics+Code+of+Professional+Conduct/Professional+Ethics](http://www.aicpa.org/Professional+Resources/Professional+Ethics+Code+of+Professional+Conduct/Professional+Ethics) for comprehensive and current information about the AICPA and the independence rules of other standard setters and regulators.

AICPA resources for practitioners are as follows:

- ▶ The AICPA Code of Professional Conduct is available at [www.aicpa.org/about/code/index.html](http://www.aicpa.org/about/code/index.html) (see ET section 100, *Independence, Integrity, and Objectivity*; ET section 302, *Contingent Fees*; and ET section 503, *Commissions and Referral Fees* [AICPA, *Professional Standards*, vol. 2]).
- ▶ Resources related to understanding and applying the provisions of Interpretation No. 101-3, “Performance of Nonattest Services,” under Rule 101, *Independence* (AICPA, *Professional Standards*, vol. 2, ET sec. 101 par. .05), can be found at [www.aicpa.org/Professional+Resources/Professional+Ethics+Code+of+Professional+Conduct/Professional+Ethics/Resources+and+Tools/Frequently+Asked+Questions.htm](http://www.aicpa.org/Professional+Resources/Professional+Ethics+Code+of+Professional+Conduct/Professional+Ethics/Resources+and+Tools/Frequently+Asked+Questions.htm).
- ▶ The document *Background and Basis for Conclusions: New Ethics Rulings Under Rule 102—Integrity and Objectivity and Rule 101—Independence* can be found at [www.aicpa.org/download/ethics/Gifts\\_Basis\\_Document.pdf](http://www.aicpa.org/download/ethics/Gifts_Basis_Document.pdf).
- ▶ For independence inquiries by phone, call (888) 777-7077, menu option #5, followed by menu option #2. Send e-mail inquiries to [ethics@aicpa.org](mailto:ethics@aicpa.org).
- ▶ The AICPA Audit Risk Alert *Independence and Ethics Developments* is published annually and is available at [www.cpa2biz.com](http://www.cpa2biz.com) or by calling 1-888-777-7077.
- ▶ The AICPA interactive CD-ROM course on independence titled *Independence* provides information on the AICPA’s and the Securities and Exchange Commission’s independence rules and qualifies for eight hours of continuing professional education credits. See [www.cpa2biz.com/AST/Main/CPA2BIZ\\_Primary/Ethics/PRDOVR-PC-739155HS/PC-739155HS.jsp](http://www.cpa2biz.com/AST/Main/CPA2BIZ_Primary/Ethics/PRDOVR-PC-739155HS/PC-739155HS.jsp).

SEC resources are as follows:

- ▶ The SEC's January 2003 rules release regarding independence is available at [www.sec.gov/rules/final/33-8183.htm](http://www.sec.gov/rules/final/33-8183.htm).
- ▶ *Office of the Chief Accountant: Application of the Commission's Rules on Auditor Independence—Frequently Asked Questions* can be found at [www.sec.gov/info/accountants/ocafaquaudind080607.htm](http://www.sec.gov/info/accountants/ocafaquaudind080607.htm).
- ▶ Information for accountants, including independence, may be found at the Office of the Chief Accountant of the United States at [www.sec.gov/about/offices/oca/ocaprof.htm](http://www.sec.gov/about/offices/oca/ocaprof.htm).
- ▶ Independence reference materials can be found on the SEC Web site at [www.sec.gov/info/accountants/independref.shtml](http://www.sec.gov/info/accountants/independref.shtml).
- ▶ U.S. Securities and Exchange Commission, Office of the Chief Accountant 100 F Street, NE, Washington, DC 20549; (202) 551-5300 (phone); (202) 772-9252 (fax).

Public Company Accounting Oversight Board (PCAOB) resources are as follows:

- ▶ The PCAOB has a Web site at [www.pcaobus.org](http://www.pcaobus.org).
- ▶ PCAOB staff questions and answers *Ethics and Independence Rules Concerning Independence, Tax Services, and Contingent Fees* can be found at [www.pcaob.org/Standards/Staff\\_Questions\\_and\\_Answers/2007/Tax\\_Services.pdf](http://www.pcaob.org/Standards/Staff_Questions_and_Answers/2007/Tax_Services.pdf).
- ▶ PCAOB Staff Questions and Answers *Attest Engagements Regarding XBRL Financial Information Furnished Under the XBRL Voluntary Financial Reporting Program on the EDGAR System* can be found at [www.pcaob.org/Standards/Staff\\_Questions\\_and\\_Answers/2005/05-25%20.pdf](http://www.pcaob.org/Standards/Staff_Questions_and_Answers/2005/05-25%20.pdf).
- ▶ PCAOB standards can be found at [www.pcaobus.org/Standards/index.aspx](http://www.pcaobus.org/Standards/index.aspx).
- ▶ PCAOB rules of the board can be found at [www.pcaob.org/Rules/Rules\\_of\\_the\\_Board/index.aspx](http://www.pcaob.org/Rules/Rules_of_the_Board/index.aspx).

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Department of Labor (DOL) resources are as follows:

- ▶ Title 29 U.S. *Code of Federal Regulations* (CFR) Part 2509.75-9. This regulation can be found at [www.dol.gov/dol/allcfr/EBSA/Title\\_29/Part\\_2509/29CFR2509.75-9.htm](http://www.dol.gov/dol/allcfr/EBSA/Title_29/Part_2509/29CFR2509.75-9.htm).
- ▶ Direct inquiries to the DOL at 1-866-4-USA-DOL.

Banking regulators' resources are as follows:

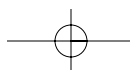
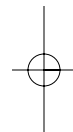
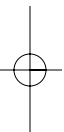
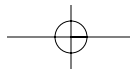
- ▶ The Federal Deposit Insurance Corporation regulations (12 CFR Part 363), *Annual Independent Audits and Reporting Requirements*, can be obtained at [www.fdic.gov/regulations/laws/rules/2000-8500.html#2000part363](http://www.fdic.gov/regulations/laws/rules/2000-8500.html#2000part363).

State Boards of Accountancy information can be found at [www.aicpa.org/Legislative+Activities+and+State+Licensing+Issues/State+News+and+Info/States/](http://www.aicpa.org/Legislative+Activities+and+State+Licensing+Issues/State+News+and+Info/States/).

International Federation of Accountants (IFAC) resources are as follows:

- ▶ Information about the International Ethics Standards Board for Accountants (IESBA) can be found on the IFAC's Web site at [www.ifac.org/Ethics/](http://www.ifac.org/Ethics/).
- ▶ The IESBA's *Code of Ethics for Professional Accountants* can be found at [www.ifac.org/Members/Pubs-Details.tmpl?PubID=10456070402914590&Category=Ethics](http://www.ifac.org/Members/Pubs-Details.tmpl?PubID=10456070402914590&Category=Ethics).





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## APPENDIX D: Documenting Independence Matters

Firms should ensure that they adequately document matters involving independence considerations in the audit working papers.

The following is an illustration of a fictional firm's documentation of an independence matter.

Date: December 18, 20XX

Client Name: Saltworth, Inc.

Lead Partner: B. Brown

Description of the Facts:

1. T. Morris is an audit partner in the Long Island, NY, office of Zaita, Rose & Associates, CPAs (the firm). T. Morris has no oversight responsibilities in the firm with regard to audit or other attestation engagements.
2. T. Morris has a daughter who is considering an employment offer from Saltworth, Inc., a Long Island-based electronics firm and attest client of the firm.
3. Saltworth, Inc. is a publicly held company whose shares are traded on the NASDAQ over-the-counter stock exchange.
4. Since 1999, the firm has performed all attestation and other services related to Saltworth, Inc.'s public filings with the Securities and Exchange Commission (SEC).
5. The lead engagement partner for this engagement is B. Brown, a Long Island office partner. B. Brown staffs and conducts the audit engagement in the Long Island office.
6. T. Morris's daughter would work in Saltworth, Inc.'s internal audit department as an internal audit director with overall responsibility for Saltworth, Inc.'s financial and operational internal audit function including the following:

- 
- 
- a.* Setting project objectives, methodology, timeline, and deliverables
  - b.* Identifying areas to be examined
  - c.* Documenting process flows
  - d.* Performing interviews
  - e.* Supervising staff
  - f.* Evaluating the adequacy of internal controls associated with business processes and adherence to controls and processes
  - g.* Analyzing data and forming recommendations
  - h.* Communicating findings and recommendations to management

(A copy of the job description and reporting lines are included as an attachment.)

7. The position being considered is a *financial reporting oversight role* in that it would allow the daughter to exercise influence over the contents of the financial statements.

8. The daughter meets the definition of a close relative (that is, nondependent child of T. Morris).

9. The SEC rules [SEC Regulation S-X Rule 2-01(c)(2)(ii)] say that a covered person (for example, a partner residing in the same office as the lead audit partner conducting the engagement) whose close relative (for example, nondependent child) has a financial reporting oversight role with the audit client impairs the firm's independence.

10. The firm, B. Brown, and T. Morris have agreed that, should the daughter plan to accept the employment offer, T. Morris will relocate to the New York City office of the firm, which is a separate and distinct office from the firm's Long Island office (that is, separate management and practice structures). Because T. Morris is not in the chain of command over this engagement, relocating to a separate office in the firm allows T. Morris to no longer be considered a covered person whose close relative's position would impair the firm's independence. Further, T. Morris would refrain from providing any services, whether attest or nonattest, to this client for any periods in which the firm is required to be independent of the client.

## APPENDIX E: Modified AICPA Independence Requirements for Certain Statements on Standards for Attestation Engagements

Rule 101, *Independence* (AICPA, *Professional Standards*, vol. 2, ET sec. 101 par. 01), and its interpretations and rulings apply to all attest engagements. However, for purposes of performing engagements to issue reports under the Statements on Standards for Attestation Engagements (SSAEs) that are restricted to identified parties, only the specified covered members and their immediate families are required to be independent with respect to the responsible party, in accordance with Ethics Rule 101. These covered members are individuals

- ▶ who participate on the attest engagement team.
- ▶ who directly supervise or manage the attest engagement partner.
- ▶ who consult with the attest engagement team regarding technical or industry-related issues specific to the attest engagement.

In addition, as covered by Interpretation No. 101-1, “Interpretation of Rule 101,” under Rule 101 (AICPA, *Professional Standards*, vol. 2, ET sec. 101 par. .02), independence would be considered to be impaired if the firm had a financial relationship with the responsible party that was material to the firm.

In cases in which the firm provides nonattest services to the responsible party that are proscribed under Interpretation No. 101-3, “Performance of Nonattest Services,” under Rule 101 (AICPA, *Professional Standards*, vol. 2, ET sec. 101 par. .05), and that do not directly relate to the subject matter of the attest engagement, independence would not be considered to be impaired.

In circumstances in which the individual or entity that engages the firm is not the responsible party or associated with the responsible party, individuals on the attest engagement team need not be independent of the individual or entity but should consider their responsibilities under Interpretation No. 102-2, “Conflicts of Interest,” under Rule 102, *Integrity and Objectivity* (AICPA, *Professional Standards*, vol. 2, ET sec. 102 par. .03), with regard to any relationships that may exist with the individual or entity that engages them to perform these services.

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This interpretation does not apply to an engagement performed under the Statements on Auditing Standards or Statements on Standards for Accounting and Review Services or to an examination or review engagement performed under SSAEs.

**Source:** Interpretation No. 101-11, “Modified Application of Rule 101 for Certain Engagements to Issue Restricted-Use Reports Under the Statements on Standards for Attestation Engagements,” under Rule 101 (AICPA, *Professional Standards*, vol. 2, ET sec. 101 par. .13), of the AICPA Code of Professional Conduct.

## APPENDIX F: AICPA Professional Ethics Division Frequently Asked Questions—Performance of Nonattest Services

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Answers to frequently asked questions (FAQs) regarding performance of nonattest services follow. The answers to these FAQs are based on guidance the AICPA Professional Ethics Division staff provided in response to members' inquiries concerning Interpretation No. 101-3, "Performance of Nonattest Services," under Rule 101, *Independence* (AICPA, *Professional Standards*, vol. 2, ET sec.101 par. .05), and have been updated through the date of this practice aid. Unless specifically noted otherwise, the Professional Ethics Division published these FAQs through various documents between May 2004 and May 2005. In an effort to make the guidance more user-friendly, the FAQs were reformatted into this document in March 2008. The FAQs are not rules, regulations, or statements of the Professional Ethics Executive Committee and, therefore, are not authoritative guidance. Further, the answers do not address the requirements of other regulatory bodies, such as the state boards of accountancy, the Securities and Exchange Commission (SEC), and the U.S. Government Accountability Office whose positions may differ from those of the AICPA.

### ***Important note:***

For the following questions, it is assumed that the member is in compliance with all applicable provisions of Interpretation No. 101-3, including, but not limited to, the general requirements<sup>1</sup> unless specifically identified otherwise and that the client in question is an attest client that is not required to file with the SEC.

1. The general requirements for performing nonattest services are the following:

- The member should not perform management functions or make management decisions for the attest client. However, the member may provide advice, research materials, and recommendations to assist the client's management in performing its functions and making decisions.
- The client must agree to perform the following functions in connection with the engagement to perform nonattest services:
  - Make all management decisions and perform all management functions

(continued)

The FAQs in this appendix cover the following topics:

- ▶ Management Functions (1 FAQ)
- ▶ Routine Activities (2 FAQs)
- ▶ Suitable Skill, Knowledge, and/or Experience (10 FAQs)
- ▶ Documentation Requirement (8 FAQs)
- ▶ Period of the Professional Engagement (1 FAQ)
- ▶ Bookkeeping Services (10 FAQs)

*(continued from previous page)*

- Designate an individual who possesses suitable skill, knowledge, and/or experience, preferably within senior management, to oversee the services
- Evaluate the adequacy and results of the services performed
- Accept responsibility for the results of the services
- Establish and maintain internal controls, including monitoring ongoing activities

The member should be satisfied that the client will be able to meet all of these criteria and make an informed judgment on the results of the member's nonattest services. In assessing whether the designated individual possesses suitable skill, knowledge, and/or experience, the member should be satisfied that such individual sufficiently understands the services to be performed to oversee them. However, the individual is not required to possess the expertise to perform or reperform the services.

In cases when the client is unable or unwilling to assume these responsibilities (for example, the client does not have an individual with suitable skill, knowledge, and/or experience to oversee the nonattest services provided or is unwilling to perform such functions due to lack of time or desire), the member's provision of these services would impair independence.

- Before performing nonattest services, the member should establish and document in writing\* his or her understanding with the client (that is, board of directors, audit committee, or management, as appropriate in the circumstances) regarding the (a) objectives of the engagement, (b) services to be performed, (c) client's acceptance of its responsibilities, (d) member's responsibilities, and (e) limitations of the engagement.

The documentation requirement does not apply to the following:

- Nonattest services performed prior to January 1, 2005.
- Nonattest services performed prior to the client becoming an attest client.\*\*

The preceding second and third general requirements do not apply to certain routine activities performed by the member, such as providing advice and responding to the client's questions as part of the normal client-member relationship.

\* A failure to prepare the required documentation would not impair independence but would be considered a violation of Rule 202, *Compliance With Standards* (AICPA, *Professional Standards*, vol. 2, ET sec. 202 par. .01), provided that the member did establish the understanding with the client. [Footnote added; effective December 31, 2003, by the Professional Ethics Executive Committee. Footnote subsequently revised January 27, 2005.]

\*\* However, upon the acceptance of an attest engagement, the member should prepare written documentation demonstrating his or her compliance with the other general requirements during the period covered by the financial statements, including the requirement to establish an understanding with the client.



- ▶ Controllership Services (1 FAQ)
- ▶ Tax Services (3 FAQs)
- ▶ Information Technology Services (8 FAQs)
- ▶ Appraisal, Valuation, and Actuarial Services (1 FAQ)

## Management Functions

1. The first general requirement under Interpretation No. 101-3 states that the member should not perform management functions or make management decisions for the attest client. What are some examples of management functions for purposes of Interpretation No. 101-3?

A management function generally would include doing or having the authority to do the following:

- ▶ Make decisions on behalf of the client
- ▶ Authorize, execute, or consummate client transactions
- ▶ Supervise, hire, or terminate client employees
- ▶ Oversee or manage any aspect of the client's business
- ▶ Set policy for the client
- ▶ Have access to or custody of client assets
- ▶ Sign or cosign client checks
- ▶ Establish or maintain internal controls for the client

*Note:* The preceding list is not intended to be all-inclusive.

Providing advice, research materials, and recommendations to assist the client's management in performing its functions and making decisions would not constitute the performance of a management function.

## Routine Activities

1. The second and third general requirements under Interpretation No. 101-3 do not apply to certain routine activities performed by the member. What are considered to be routine activities for purposes of the interpretation?

Whether an activity is routine should be determined by considering all of the facts and circumstances surrounding the activity. Routine activities generally involve providing advice or assistance to the client on an informal basis as part of the normal client-member relationship. Routine activities typically are insignificant in terms of time incurred or resources expended and generally do not result in a specific project or engagement or in the member producing a formal report or other formal work product. Examples of routine activities may include the following:

- ▶ Providing advice to the client on an accounting matter as an ancillary part of the overall attest engagement
- ▶ Researching and responding to the client's technical questions on relevant tax laws as an ancillary part of providing tax services
- ▶ Providing advice to the client on routine business matters
- ▶ Educating the client on matters within the technical expertise of the member
- ▶ Providing information to the client that is readily available to the member, such as best practices and benchmarking studies

2. Is a member permitted to assist the client in understanding the nature of adjusting entries and their impact on the financial statements?

Yes. If a client needs assistance in understanding the nature of the entries and their impact on the financial statements, the member may explain the accounting principles giving rise to the adjustments, as well as the impact of the adjustments on the financial statements.

## **Suitable Skill, Knowledge, and/or Experience**

1. What does suitable skill, knowledge, and/or experience mean in the context of Interpretation No. 101-3?

*Suitable skill, knowledge, and/or experience* means that the individual designated to oversee the nonattest service has the ability to understand the nature, objective, and scope of the nonattest service. Overseeing the service does not require the designated individual to supervise the member in the day-to-day rendering of the services. Rather, the individual should agree on the nature, objective, and scope of the services; receive periodic progress reports when appropriate; make all significant judgments; evaluate the adequacy and results of the service; accept responsibility for the service results; and ensure that the resulting work product meets the agreed-upon specifications. The skill, knowledge, and/or experience needed will vary depending on the nature of the nonattest service. For example, the skill, knowledge, and/or experience needed to oversee a payroll service can be expected

to be different than the skill, knowledge, and/or experience needed to oversee a complex tax service. The requirement for the designated individual to possess suitable skill, knowledge, and/or experience does not, however, require that the individual possess the technical expertise that the member possesses or the ability to perform or reperform the services.

2. Is the requirement that the client possess suitable skill, knowledge, and/or experience to oversee the nonattest services provided by the member a new provision?

No. Since the mid-1970s, Interpretation No. 101-3 has called for the attest client to undertake certain responsibilities in connection with the delivery of various nonattest services. For example, at various times the rule has called for the client to “be sufficiently knowledgeable,” “sufficiently informed,” and “have an informed judgment on the results of the nonattest service.” These requirements necessitate oversight by an individual with suitable skill, knowledge, and/or experience.

3. Why does the rule require an individual who possesses suitable skill, knowledge, and/or experience to oversee the nonattest services provided by the member?

If the individual designated by the client does not possess suitable skill, knowledge, and/or experience to oversee the nonattest service, there would be no one (other than the member) to make the significant judgments that become necessary during the delivery of the service or discharge the other client responsibilities under Interpretation No. 101-3. Performing those activities on behalf of the attest client would be inconsistent with the member’s requirement to be independent of the client.

4. What are the underlying concepts that support the conclusion that a member’s independence would be impaired if an individual designated by the client with suitable skill, knowledge, and/or experience does not perform the activities described in the interpretation?

Two threats to a member’s independence arise if the member assumes the client’s responsibilities under Interpretation No. 101-3. First a “self-review threat” arises when the member reviews, as part of an attest engagement (for example, an audit), evidence that results from his or her (or his or her firm’s) own nonattest work. That could happen, for example, when the member makes significant judgments on behalf of the client during the performance of the nonattest service, or the designated client individual lacks suitable skill, knowledge, and/or experience to evaluate the adequacy and results of the service and accept responsibility for those results. In that situation, the member has a disincentive to challenge the related financial statement amounts because doing so could call into question his or her (or his or her firm’s) own work. That disincentive is inconsistent with the need for the member to be independent and objective with respect to the client. The

second threat that arises is a “management participation threat.” Making significant judgments on behalf of the attest client during the performance of the nonattest service causes the member to function as management in connection with the service. That also is inconsistent with the need for the member to be independent and objective with respect to the client. By ensuring that an individual designated by the client with suitable skill, knowledge, and/or experience oversees the member’s nonattest services and makes all management decisions, both threats are eliminated.

5. How should a member assess whether the individual designated by the client to oversee the nonattest service possesses suitable skill, knowledge, and/or experience?

In assessing whether the designated individual has suitable skills, knowledge, and/or experience to oversee a nonattest service, the member might consider the following factors that pertain to the individual:

- ▶ Understanding of the nature of the service
- ▶ Knowledge of the client’s business
- ▶ Knowledge of the client’s industry
- ▶ General business knowledge
- ▶ Education
- ▶ Position at the client

Some factors may be given more weight than others, depending on the nature of the service. For example, although the level of education attained by the individual can be one indicator of his or her skills and/or knowledge, it is not necessarily true that the more formal education the individual possesses, the more able he or she would be to oversee the nonattest service. If the individual understands the nature of the service and possesses a sufficient knowledge of the client’s business and industry, he or she may have the skills, knowledge, and/or experience to oversee the service, regardless of the level of education he or she possesses. For example, most small business owners know their company’s operations and financial position better than anyone, and they understand the services they need from the member and what those services are intended to accomplish. Because they are the owners of the business, they regularly make important decisions about all matters affecting their business. Accordingly, members might conclude that those individuals would possess the necessary skills, knowledge, and/or experience to understand the services being performed; make any management decisions; and determine whether the results of the services meet the agreed-upon specifications.

6. Interpretation No. 101-3 requires that the client designate an individual who possesses suitable skill, knowledge, and/or experience, preferably within senior management, to oversee the nonattest services. Which individual(s) at the client can serve in this capacity (for example, the owner[s], controller, or bookkeeper)?

The individual(s) designated by the client will likely depend on the nature of the client's organization and the nature of the nonattest engagement. In an owner-managed business, it will often be the owner, but depending on the nature of the nonattest services and the qualifications (that is, skill, knowledge, and/or experience) of other client employees or individuals, it also could be the controller, bookkeeper, or another employee. In larger organizations or for more complex services, the client is more likely to designate a senior officer to oversee the services. The employee or individual responsible for overseeing the nonattest services needs to understand the services sufficiently to oversee them but does not need to possess the technical qualifications to perform or reperform the services.

For example, consider a nonattest engagement in which the member has been asked to provide investment advisory services that include recommendations on the allocation of funds that the client should invest in various asset classes based on the client's desired rate of return and risk tolerance. The owner of the company has knowledge of the company's investment objectives and therefore serves as the client designee. The owner makes all investment decisions concerning the allocation of funds and investment selections and accepts responsibility for the resulting investment plan. For purposes of this nonattest engagement, the member may conclude that the owner of the company possesses the skill, knowledge, and/or experience to oversee the service. On the other hand, consider an engagement when the member is asked to install an off-the-shelf accounting package and set up the chart of accounts and financial statement format for a small business client. The owner of the company is traveling on business and designates the office manager to oversee the installation. The office manager primarily performs routine clerical and receptionist functions for the business and has limited understanding of the company's operations. He or she has never used accounting or financial software, such as the application being installed by the practitioner. In addition, because the company hires a part-time bookkeeper to maintain its general ledger and subsidiary records, the office manager has no understanding of the company's books or records and financial statements. For purposes of this nonattest engagement, it appears unlikely that the office manager would be in a position to sufficiently understand the services being performed to oversee them and accept responsibility for the resulting accounting system.

7. May the client contract with a third party who is not an employee of the client to oversee or advise on the member's performance of the nonattest service?

The client may contract with a third party to advise management regarding the nature of the services and the evaluation of the adequacy and results of the services in order to enable management to effectively oversee the services, perform all management functions, make all management decisions, accept responsibility for the services, and maintain internal controls over the services.

When the client outsources the nonattest services oversight functions to a third party, such third party may serve as the individual designated by the client to oversee the nonattest services provided he or she possesses the necessary skill, knowledge, and/or experience; functions in a capacity equivalent to that of a client employee; and has the authority to make decisions on behalf of the client.

8. How can a member be satisfied that the client designee understands the nonattest services performed and the resulting work product?

Members are expected to utilize their professional judgment and experience to recognize which individuals are able and willing to fulfill the client responsibilities that are set forth in the interpretation. Through interaction with the client owner(s) or client employees, experienced practitioners should be able to assess whether the designated client individual possesses the skill, knowledge, and/or experience to effectively oversee the nonattest service.

9. A client has difficulty understanding deferred tax assets and deferred tax liabilities. What must a client know about these concepts in order to be considered to possess the skill, knowledge, and/or experience necessary to fulfill the requirement(s) under Interpretation No 101-3?

The intent of Interpretation No. 101-3 is not for the client to possess a level of technical expertise commensurate with that of the member. In the case of deferred taxes, the client should understand the basis for the deferred tax assets or liabilities and the impact of the deferred taxes on the financial statements.

10. What are some examples of nonattest services and the level of understanding that the client designee should possess in order to comply with Interpretation No. 101-3?

*Bookkeeping*—When the member performs routine bookkeeping services for an audit, review, or compilation client, the member should be satisfied that the designated individual understands the reason why the journal entries are being proposed and the effect they have on the financial statements. For recurring or standard journal entries (for example, depreciation), the designated individual may require no explanation regarding the reason for the

entry (for example, when the member has previously discussed these entries with the client), whereas for more complex journal entries (for example, deferred taxes), the member may need to explain to the client the reason and basis for the entry and its impact on the financial statements. In any case, the individual should be in a position to approve the proposed journal entries and accept responsibility for the company's financial statements.

*Tax Services*—For tax return preparation engagements, the individual designated by the client need not have an understanding of the applicable tax laws; however, the member should have the designated individual review the tax return with an emphasis on the key tax positions taken. The member also should be satisfied that the individual understands the company's tax situation, has a general understanding of how the amounts on the tax return were determined, and make all decisions regarding significant tax positions taken in the return.

*Valuation Services*—For more complex engagements, such as permitted valuation services, the member may need to explain to the individual designated by the client the valuation methodologies used as well as all significant assumptions. The individual then should be in a position to approve all significant assumptions and accept responsibility for the resulting valuation.

## Documentation Requirement

1. The third general requirement of Interpretation No. 101-3 requires that the member should establish and document in writing his or her understanding with the client regarding the (a) objectives of the engagement, (b) services to be performed, (c) client's acceptance of its responsibilities, (d) member's responsibilities, and (e) limitations of the engagement. Would a member be in compliance with this requirement if the preceding points were documented in an engagement letter, the audit planning memo, or in a memo of understanding maintained in the member's billing files?

Yes. The general requirements of Interpretation No. 101-3 only require a member to document his or her understanding with the client and do not indicate any specific method of documentation. The methods indicated are not all-inclusive, and other methods may be appropriate as well. FAQ No. 2 that follows provides further details, including illustrative sample language.

2. What form of documentation is required?

Although the rule requires that the understanding with the client must be in writing, the form of documentation is left to the member's discretion. The method of documentation



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is not as important as the content of the documentation. For example, if the member performs a consulting engagement for an audit client, the member may decide to document the required elements with respect to the consulting engagement in the audit engagement letter. The understanding also could be documented, for example, in a separate engagement letter specific to the consulting service engagement, a memo to the audit files, or a checklist that the member completes as part of the audit. If a client engages the member to perform tax services, the understanding could be documented in a tax organizer or a memo contained in the tax working papers. Other methods of documentation, such as a memo of understanding maintained in the member's billing or correspondence files (that is, separate from the client working paper files), also would satisfy this requirement. The following is illustrative sample language that can be incorporated into an audit, review, or compilation engagement letter; a "stand-alone" nonattest services engagement letter; a tax organizer letter; or other documentation method preferred by the member:

Sample Language to Document Understanding With the Client for the Provision of  
Bookkeeping and Tax Services

**Objectives of the Engagement and Services to be Performed**

1. We provide the bookkeeping and tax services outlined as follows:
  - ▶ At the end of each month, CPA Firm agrees to perform the following functions:
    - Post coded transactions to ABC Company's general ledger
    - Propose adjusting or correcting journal entries to be reviewed and approved by ABC Company
    - Prepare a trial balance based on the adjusted general ledger
    - Prepare monthly sales and payroll tax returns [*insert applicable tax jurisdictions*]
  - ▶ At the end of the year, CPA Firm agrees to perform the following functions:
    - Propose adjusting or correcting journal entries to be reviewed and approved by ABC Company
    - Prepare federal and state income tax returns [*insert applicable tax jurisdictions*]
    - Prepare year-end sales and payroll tax returns [*insert applicable tax jurisdictions*]
    - Answer inquiries on specific tax matters
  - ▶ CPA Firm will not perform management functions or make management decisions on behalf of ABC Company. However, we will provide advice and recommendations to assist management of ABC Company in performing its functions and making decisions.
2. ABC Company's responsibilities are as follows:
  - ▶ ABC Company agrees to perform the following functions in connection with CPA Firm's provision of the bookkeeping and tax services:
    - Make all management decisions and perform all management functions, including determining account codings and approving all proposed journal entries
    - Assign [*name of competent client employee*] to oversee the bookkeeping and tax services and evaluate the adequacy and results of the services
    - Accept responsibility for the results of the bookkeeping and tax services, including the journal entries, general ledger, trial balance, and tax returns
    - Establish and maintain internal controls over the bookkeeping and tax return preparation processes
3. CPA Firm's responsibilities and limitations of the engagement are as follows:
  - ▶ CPA Firm will perform the services in accordance with applicable professional standards, including the Statements on Standards for Tax Services issued by the AICPA.
  - ▶ This engagement is limited to the bookkeeping and tax services previously outlined. CPA Firm, in its sole professional judgment, reserves the right to refuse to do any procedure or take any action that could be construed as making management decisions or performing management functions, including determining account codings and approving journal entries. CPA Firm will advise ABC Company with regard to tax positions taken in the preparation of the tax return, but ABC Company must make all decisions with regard to those matters.

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3. What clients are affected by the documentation requirement?

The documentation requirement applies to any nonattest services (for example, bookkeeping, tax, or consulting services) performed by the member for an attest client. For purposes of this rule, an *attest client* is any client for which the member performs any service for which independence is required. Accordingly, for purposes of this rule, a client for which a member performs a compilation would only be considered an attest client if the member's compilation report does not disclose a lack of independence.

Other regulators may have more restrictive rules regarding independence when performing nonattest services for an attest client. Accordingly, the member should be aware of and comply with all rules and regulations applicable to specific clients.

4. Are any activities excluded from the documentation requirement?

The documentation requirement does not apply to routine activities performed by the member, such as providing advice and responding to the client's technical questions as part of the normal client-member relationship. See FAQ No. 1 under the heading "Routine Activities."

5. Would independence be impaired when a member fails to document the understanding with the client?

No. A failure to prepare the required documentation would not impair the member's independence provided the understanding with the client had been established. However, the failure to document the understanding with the client would be considered a violation of Rule 202, *Compliance With Standards* (AICPA, *Professional Standards*, vol. 2, ET sec. 202 par. .01).

6. A member provides only nonattest services to a client for the year ending December 31, 2004. In 2005, the member is asked to perform an audit of the client's year-end 2004 financial statements. Would the member be in violation of the third general requirement under Interpretation No. 101-3 because the firm did not comply with the documentation requirement with respect to the nonattest services performed in 2004?

No. The documentation requirement does not apply to nonattest services performed prior to the client becoming an attest client. However, upon the acceptance of an attest engagement, the member should prepare written documentation demonstrating his or her compliance with the other general requirements of Interpretation No. 101-3 during the period covered by the financial statements, including the requirement to establish an understanding with the client.

7. Must a member document the client's review and approval of journal entries proposed by the member?

Interpretation No. 101-3 does not require that the member document the client's review and approval of the journal entries. However, the member may wish to document the name of the client representative who reviewed and approved the journal entries and the date of his or her review to provide evidence that such review and approval took place.

8. A member's firm does not require its clients to sign engagement letters for tax return preparation services. How does the documentation requirement under Interpretation No. 101-3 apply with respect to these clients?

Tax services are nonattest services subject to the requirements of Interpretation No. 101-3. Therefore, the documentation requirement applies when the member provides tax services to a client for which the member also provides attest services. However, the method of documentation is left to the member's discretion, and, provided it contains all of the required elements, it could be documented in a tax organizer or disclosure statement provided to the client, a memo in the tax or attest service working papers, or through other means.

## Period of the Professional Engagement

1. Would a member's independence be considered impaired if a member performed services that would impair independence under Interpretation No. 101-3 during the period covered by the financial statements but prior to the period of the professional engagement?

Interpretation No. 101-3 states that in cases when the requirements of the interpretation have not been met during the period of the professional engagement or the period covered by the financial statements, the member's independence would be impaired. However, independence would not be considered impaired provided the services (a) do not constitute management functions, (b) were performed prior to the period of the professional engagement, (c) relate solely to financial statements of the prior period, and (d) those financial statements were audited by another firm (or in the case of a review engagement, reviewed or audited by another firm). See FAQ No. 1 under the previous heading "Management Functions" and ET section 100.01, *Conceptual Framework for AICPA Independence Standards* (AICPA, *Professional Standards*, vol. 2), for further guidance on what would constitute a management function (issued November 2007).

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## Bookkeeping Services

1. A member records journal entries while performing monthly bookkeeping services without obtaining client approval. Would independence be impaired?

Yes. In order for the member to maintain his or her independence, the client must review and approve the journal entries, and the member should be satisfied that management understands the nature of the proposed entries and the impact the entries have on the financial statements.

2. During the course of providing monthly bookkeeping services, the member receives invoices from the client indicating approval for payment and identifying the appropriate general ledger accounts to record the transaction. The member prepares the client's checks for payment of those invoices, records the transactions in the client's general ledger system, and returns the checks to the client for approval and signature. The member does not have signature authority over the client's checking account. Would independence be impaired?

No. Management determined and approved the appropriate account classifications, approved the invoices for payment, and reviewed and signed the prepared checks.

3. During the course of providing monthly bookkeeping services, the member discusses with client management the need to record recurring journal entries (for example, depreciation expense) each month in the general ledger. The client approves the recurring journal entries and makes any necessary decisions (for example, useful lives of the assets). The member then records these entries in the client's general ledger each month. Would independence be impaired?

No. The client understands the general nature of the journal entries and the impact they have on its financial statements.

4. A client records all disbursements in its checkbook and identifies the type of expense (for example, telephone, rent, and so on) on the checkbook stubs. During the course of providing monthly bookkeeping services, the member assigns the general ledger account number based on the type of expense indicated by the client and records these payments in the client's accounting system. Would independence be impaired?

No. The member would not be considered coding transactions.

5. A member is engaged to perform an audit, review, or compilation of a client's financial statements. During the course of the audit, review, or compilation, the member proposes

audit adjustments to the financial statements. Examples of these entries include the current tax accrual and deferred tax assets or liabilities and the amount of depreciation and amortization necessary for the current year. The client reviews these entries, understands the impact on its financial statements, and records the adjustments identified by the member. Would the proposal of such entries constitute a nonattest bookkeeping service subject to Interpretation No. 101-3?

No. Proposing entries as a result of the member's audit, review, or compilation services is a normal part of those engagements and would not constitute performing a nonattest bookkeeping service subject to Interpretation No. 101-3.

6. A member is engaged to perform an audit for a client who records all transactions on a cash basis in its general ledger. During the audit process, the member identifies all appropriate journal entries required to convert the client's general ledger to an accrual basis and prepares the financial statements, including footnotes, on the accrual basis in order to conform with generally accepted accounting principles. The client reviews the entries and financial statements, including all footnote disclosures, and understands the impact these entries have on the financial statements. As part of the management representation letter, the client acknowledges responsibility for the financial statements and footnotes. Would these services be considered nonattest bookkeeping services subject to Interpretation No. 101-3?

No. Providing these services as part of the member's audit of the client's financial statements would not be considered bookkeeping services subject to the requirements of Interpretation No. 101-3. In addition, a member should use judgment concerning what would be considered part of the normal audit process and what would be a separate nonattest service. A client's books and records have to be substantially complete and current in order to conduct an audit of those books and records. The client's books and records would include all subsidiary ledgers or information required by the auditor (such as accounts receivable or payable) for the necessary conversion. If a member performs a service to bring those books and records current or complete (such as compiling the subsidiary information), the service should be considered outside the scope of the normal audit process and, therefore, a nonattest service subject to Interpretation No. 101-3. However, Interpretation No. 101-3 would be applicable when the member is engaged to perform a stand-alone bookkeeping engagement for the client. An example would be when a member is engaged to perform monthly bookkeeping services, including the preparation of monthly compiled financial statements.

7. The member prepares a bank reconciliation of a client's bank account in connection with monthly bookkeeping services. The client reviews and approves the bank reconciliation. Would independence be impaired?

No. The client reviews and approves the bank reconciliation and sufficiently understands the services performed to oversee them.

8. A member performing bookkeeping services records adjusting and reclassification journal entries and compiles preliminary financial statements. The member delivers the financial statements and compilation report to the client and provides the client copies of the general ledger, journals, and journal entries, which contain a description of the nature of each entry. The member asks the client to review the journal entries and then asks whether the client has any questions about any of the entries. Would the requirements of Interpretation No. 101-3 be met?

Yes. Provided the member is satisfied that the client understands the nature and impact of the journal entries, the requirements of Interpretation No. 101-3 would be met.

9. Must the member review the proposed journal entries and explain their impact on the financial statements to the client in person or can this review take place by phone, fax, mail, or e-mail?

The review process can take place in person; by phone, fax, mail, or e-mail; or a combination thereof. Regardless of the method used, the member must be satisfied that the client understands the nature and impact of the journal entries.

10. As part of performing bookkeeping services, a member records adjusting journal and reclassification entries and prepares the client's preliminary financial statements. The member does not review each and every journal entry with the client, but, rather, the member describes the nature of the journal entries and their impact on the preliminary financial statements. The client approves the preliminary financial statements and issues them to its bank. Would the requirements of Interpretation No. 101-3 be met?

Yes. Provided all of the other requirements of Interpretation No. 101-3 are met.

## **Controllorship Services**

1. A member provides temporary controllorship services and various types of other temporary accounting services for clients during client maternity leaves, illnesses, and sudden departures. Do these activities impair independence under Interpretation No. 101-3?

These services would be subject to Interpretation No. 101-3. If a member performs controller-type activities, independence would be impaired because such activities typically involve the performance of management functions or the supervision of client employees.

However, if the member performs temporary accounting and other services in compliance with the requirements of Interpretation No. 101-3, independence would not be impaired. The member also should consider whether the duration or regularity of the services might appear to impair independence. Having the title of controller would impair independence regardless of the actual services performed.

## Tax Services

1. The member performs year-end tax planning and prepares the tax returns for an attest client. Would these services be considered nonattest services and therefore subject to the requirements of Interpretation No. 101-3?

Yes. Tax services are considered nonattest services and are therefore subject to the general requirements of Interpretation No. 101-3, including the member's understanding with the client with respect to the tax services that must be documented in writing.

2. Does Interpretation No. 101-3 apply when the member prepares the personal tax returns of the owners and officers of an audit, review, or compilation client? Does it matter whether the owners or officers pay for the services themselves or whether the client pays for the services as an executive perk?

If the personal tax returns are prepared without having to rely on representations of the client, then Interpretation No. 101-3 would not apply. The mere fact that the client pays for the services also would not cause Interpretation No. 101-3 to apply.

3. Would assisting a client in applying Financial Accounting Standards Board Interpretation No. (FIN) 48, *Accounting for Uncertainty in Income Taxes—an interpretation of FASB Statement No. 109*,<sup>2</sup> impair independence (for example, identifying potential uncertain tax positions, advising the client whether those tax positions meet the more-likely-than-not [MLTN] threshold, and calculating the related unrecognized tax benefits)?

The provision of such services would not impair independence provided the client can make an informed judgment on the results of the member's services and the other requirements of Interpretation No. 101-3 are met. In meeting the requirements of Interpretation No. 101-3, the member may assist the client in understanding why the tax positions do or do not meet the MLTN threshold and the basis for any unrecognized tax benefit so that

2. At the time of this writing, the Financial Accounting Standards Board (FASB) was expected to make the FASB *Accounting Standards Codification*<sup>TM</sup> (FASB ASC) authoritative effective July 1, 2009. FASB Interpretation No. 48, *Accounting for Uncertainty in Income Taxes—an interpretation of FASB Statement No. 109*, has been codified at FASB ASC 740, *Income Taxes*.



the client can accept responsibility for the amounts reported and disclosed in the financial statements (issued July 2007).

## Information Technology Services

1. Why does Interpretation No. 101-3 indicate that independence would be impaired if a member is operating a client's local area network (LAN) system?

Operating a client's LAN is considered to be a management function that would violate the general requirements of Interpretation No. 101-3.

2. Would outsourcing the client's entire network operation and independently operating the client's LAN system impair independence?

Yes.

3. Would performing network maintenance (for example, updating virus protection, applying updates and patches, or configuring user settings consistent with management's request) impair independence?

No. Performing network maintenance is not considered to be operating the client's network and, therefore, would not impair independence provided a client employee with the necessary skill, knowledge, and/or experience is making all decisions and approving all activities.

4. Would assisting a client with a server project (for example, install, migrate, or update its network operating system; add equipment and users; or copy data to another computer) impair independence?

No. Provided the member does not make other than insignificant modifications to the source code underlying the client's financial information system.

5. Would supervising client personnel in the daily operation of the client's information system impair independence?

Yes. In this case, the member would be performing management duties (supervising client employees in the performance of their normal recurring activities), which would impair independence.

6. Would assisting a client with procuring and securing Internet access impair independence?

No. Provided a client employee with the necessary skill, knowledge, and/or experience makes all decisions concerning the Internet provider and services to be provided.

7. What criteria should a member use to determine whether a client's information system is unrelated to its financial statements or accounting records?

Information systems that produce information that is reflected in the amounts and disclosures in the client's financial statements, used in determining such amounts and disclosures, or used in effecting internal control over financial reporting are considered to be related to the financial statements and accounting records. However, information systems that are used only in connection with controlling the efficiency and effectiveness of operations are considered to be unrelated to the financial statements and accounting records.

8. What factors should a member consider in determining whether the modifications made to source code underlying a client's financial information system are other than insignificant?

If the modifications have more than an insignificant effect on the functionality of the software, they should be considered to be other than insignificant.

## Appraisal, Valuation, and Actuarial Services

1. Would assisting a client in applying FASB Statement No. 141 (revised 2007), *Business Combinations*, or FASB Statement No. 142, *Goodwill and Other Intangible Assets*,<sup>3</sup> impair independence (for example, providing advice on the various valuation methodologies available and assumptions needed and providing valuation templates, software, or other tools so that the client can determine an appropriate value for acquired assets, goodwill, contingent consideration, and so on)?

When the client requests that the member perform valuation services or when the member is in essence performing the valuation for the client (such as when the member provides the client with a firm-developed template or software product or inserts amounts into a template or software product), the member should refer to the guidance in Interpretation

3. At the time of this writing, FASB was expected to make the FASB ASC authoritative effective July 1, 2009. FASB Statement No. 141 (revised 2007), *Business Combinations*, has been codified at FASB ASC 805, *Business Combinations*. FASB Statement No. 142, *Goodwill and Other Intangible Assets*, has been codified at FASB ASC 350, *Intangibles—Goodwill and Other*.

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No. 101-3. That guidance states that independence would be impaired if a member performs an appraisal or valuation service for an attest client when the results of the service would be material to the financial statements and the appraisal or valuation involves a significant degree of subjectivity. Valuations performed in connection with business combinations or appraisals of assets or liabilities normally materially affect the financial statements and involve a significant degree of subjectivity.

Providing advice on the various valuation methodologies available and assumptions to be made in performing the valuation would not impair independence provided the requirements of Interpretation No. 101-3 are met. These requirements include the client determining or approving all significant assumptions and matters of judgment and making an informed judgment on, and accepting responsibility for, the results of the service. In meeting the requirements of Interpretation No. 101-3, the member also may assist the client in understanding the accounting standards and the nature of the necessary accounting adjustments.

In addition, the member may provide the client with generic or standardized templates or software products not developed by the firm to assist the client with performing the valuation. *Generic or standardized products* are those in which formulas are well established and subject to only minor judgments or interpretations. Accordingly, it is reasonable to expect that the result produced by such products will be similar to the result that would be produced by other vendors' products (issued August 2008).

## **APPENDIX G: Other Independence Rules and Issues**

### **State Accountancy Boards**

The states have independence rules that may be similar to the AICPA, Securities and Exchange Commission (SEC) and Public Company Accounting Oversight Board; however, some states have more restrictive rules. For example, the California accountancy board has a rule similar to the SEC's "cooling off" provision; however, the California board's rule applies to both public and nonpublic entities. Therefore, the accountancy board's rules pertaining to the state in which the audit or other attest service is being performed should be carefully reviewed. In addition, auditors holding individual licenses from other states should be mindful of their home state independence and ethics requirements whenever they perform audit or other attest services.

### **European Union**

The European Union (EU), in directive 2006/43/EC of the European Parliament and of the Council, requires EU Member States adopt (at minimum) certain independence rules that apply to statutory audit engagements performed for public interest entities (audit clients), including, for example, a two-year "cooling off" period for a key audit partner who joins an audit client as a CEO, CFO, CAO, or an equivalent position; audit partner rotation requirements; and audit committee communications. The rules, which may vary from one Member State to another, apply to EU-domiciled audit clients and subsidiaries of non-EU audit clients operating in the EU. See <http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=OJ:L:2006:157:0087:0107:EN:PDF> for further information.

### **Stock Exchange Listing Requirements**

#### **Directorships at NYSE- and NASD-Listed Companies**

The New York Stock Exchange and the National Association of Security Dealers have adopted listing requirements that require directors to be independent. Although these rules do not affect the audit firm's independence, a client's failure to comply with them may jeopardize its listing on the related stock exchanges. For example, to be considered an independent director, among other things, a director must not be associated with the audit

firm for a period of three years. In addition, directors are not independent if certain of their family members work for the audit firm.

## **U.S. Government Accountability Office**

The U.S. Government Accountability Office (GAO) promulgates independence and ethics rules that apply to financial statement audits; attestation services; and performance audits of government entities, programs, and federal awards administered by contractors, nonprofit entities, and other nongovernmental entities. These rules appear in *Government Auditing Standards*. For example, performing an audit of a university that issues debt in the public marketplace and receives government funding would require independence under AICPA, SEC, and GAO rules.

## **Federal Financial Institutions Examination Council**

The Federal Financial Institutions Examination Council (FFIEC) comprises the Office of Thrift Supervision, the Board of Governors of the Federal Reserve System, the Federal Deposit Insurance Corporation (FDIC), the National Credit Union Administration, and the Office of the Comptroller of the Currency. The FFIEC issues financial institution letters (FILs), which are addressed to the chief executive officers of the financial institutions on the FIL's distribution list (generally, FDIC-supervised institutions). FILs may announce new regulations and policies, new FDIC publications, and a variety of other matters of principal interest to those responsible for operating a bank or savings association. FILs have addressed auditor conduct (for example, internal audit outsourcing and use of indemnification clauses in engagement letters) in recent years.

## **Department of Labor**

Auditors of employee benefit plans that file reports with the Department of Labor should be aware of Title 29 U.S. *Code of Federal Regulations* (CFR) Part 2509.75-9.













